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Austrian Theorizing: Recalling the Foundations **Walter Block**

A Pre-History of Misesian Calculation: The Contribution of Adolphe Thiers **Reinhard Stiebler**

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ECONOMIC SCIENCE AND NEOCLASSICISM

JÖRG GUIDO HÜLSMANN

For more than forty years, economists have routinely rejected the postulate that economic theory should be realistic. Ever since Milton Friedman (1953) sketchily outlined a positivistic methodology for economics, most students of our science have come to endorse Friedman's view and have claimed that the only quality standard of economic reasoning was its predictive power. Good theories yield fairly correct predictions whereas bad theories yield wrong predictions.

Today, the utter failure of this program is patent. Positivism has not improved economic forecasting. It has encouraged the preoccupation with purely formal problems in mathematical economics and game theory, and at the same time the multiplication of applied studies proving, in the words of Frank H. Knight, that "water runs downhill." Not surprisingly, more and more economists seek to find their way between the Scylla of formal irrelevance and the Charybdis of empirical irrelevance. Ever more economists have become interested in alternative approaches that point out avenues for gaining meaningful insights about our world.

One of the few schools of economic thought that has consistently adhered to the postulate of economic realism is the Austrian School.[1] It is therefore welcome that Bryan Caplan (1999) critically evaluated the tenets of the Austrians in a recent article. He concentrated on the writings of Ludwig von Mises and Murray N. Rothbard. The works of these two authors represent in his eyes a truly alternative paradigm within the economics profession, whereas the work of other Austrian scholars—in particular, Hayek, Kirzner, and their followers—has to be seen as complementary to, rather than altogether different from, today's neoclassical mainstream.[2]

JÖRG GUIDO HÜLSMANN is a Feodor-Lynen Fellow at the State University of New York at Buffalo. I thank the Ludwig von Mises Institute (Auburn, Ala.) and the Alexander von Humboldt Foundation (Bonn, Germany) for financial support.

[1]See in particular Menger (1871; 1883); Böhm-Bawerk (1959; 1923); Mises (1998; 1985); Hayek (1931; 1937; 1979); Rothbard (1993; 1997a,b); Kirzner (1966; 1973); and Hoppe (1989; 1993).

[2]See Caplan (1999, pp. 823f., 836, n. 24). This view finds corroboration in recent studies by Austrian economists. See Rothbard (1997a, chap. 7); Salerno (1990b; 1993; 1999); Block and Garschina (1996); Herbener, Salerno, and Hoppe (1989); and Hoppe and Salerno (1999).

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Caplan arrives at the startling conclusion that the Austrian approach, despite the efforts of its authors, is *less* realistic than the neoclassical approach that flourished in the age of benign neglect for realism.

A discussion of these views is highly useful given the growing interest in economic realism. In this article, we will show that Caplan fails to identify the important differences between Austrian and neoclassical economics. Caplan's errors seem all to be rooted in his failure to grasp that Austrian economics is a theory of action (praxeology) rather than some kind of applied psychology. We will therefore briefly characterize the praxeological approach toward the explanation of human behavior and then discuss Caplan's main tenets in some detail.

THE ESSENCE OF PRAXEOLOGICAL ANALYSIS

Human beings act. They employ means to attain ends, and they choose means and ends. These facts are evident, simple, and clear, and no reasonable economist denies them. What sets the Austrian approach apart is its way of dealing with them. Austrians base their all-encompassing economic theory *exclusively* on these and other such elementary facts. They stress that human beings make choices and that they use means to attain ends.

Yet how is it possible, one might ask, to explain human action by the fact *that* human beings act? To explain a thing means to point out a relationship in which the thing stands. We can explain the fact that a leaf falls to the ground by the existence of gravity. We can explain the fact that a bulb lights a room by certain laws of electricity. We can explain the fact that a car runs by the combined effect of certain properties of fuel, laws of combustion, etc. In all these cases we explain the fact under consideration by pointing out its relation to *other* facts. An explanation thus presupposes that the fact is a sequel or corollary of the other facts. However, Austrian economists contend that they explain human action by the very fact that human beings act. Is this not circular reasoning rather than an explanation of action?

The answer is that, strictly speaking, Austrian economists do not explain human action at all. They do not relate human action to other facts of which it would be sequel or corollary. What they do is to analyze what human action *is*. They point out that each human action *contains* relationships between realized and non-realized aspects of this very action. Movements of the human body (human behavior) and mental activities (thinking, listening, etc.) can then be explained by reference to these relationships inherent in human action.

In short, Austrian economics is based on the insight that human behavior and human thoughts are *only a part* of human action, namely, the part that is realized (that is "there"). Other parts of human action are not—or not yet—realized. These are, in particular, (a) the purposes in pursuit of which human beings act and (b) the foregone alternatives that could have been chosen. Purposes and foregone alternatives are obviously not part of the world in the sense that they are realized.

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However, it cannot be denied that they have some sort of existence, and this undeniable fact puts Austrian economists in a position to explain the realized manifestation of human action (behavior and thoughts) as a corollary of the non-realized part. For example, we can say that George went to work *in order to* earn his living, or that Judy crossed the street *in order to* get to the bakery. Or, when we observe a person play piano we can state that he plays piano *rather than* doing other things. We add another explanation by stating that he *prefers* playing piano to doing those other things. And so on. In all these explanations we use our knowledge of human action to explain the realized part by the not—or not yet—realized part.

Thus we see how Austrian economists can build all their theories on the mere facts *that* human beings use means to attain ends and *that* they choose means and ends. Neoclassical economists are not even aware that this approach is possible. In any case, they seek to explain human action in terms altogether different from their Austrian colleagues. They want to analyze how people act as a corollary or sequel of given circumstances; that is, they want to explain human behavior in terms of other observable and introspectively knowable facts. Clearly, to perform *this* kind of analysis one needs to have more than just knowledge of the relationships between realized and non-realized elements of human action. Thus, the neoclassical theory of value and choice seeks to explain how people should or would act by relating their behavior to feelings of pain and pleasure, or more generally to feelings of satisfaction. In short, neoclassical value theory not only stresses that what we feel determines how we behave. It presupposes that there are *constant relationships* between our feelings on the one hand, and our behavior on the other hand that can be studied and described by the neoclassical consumer theory.

Such are the problems that monopolize the attention of neoclassical economists. Their efforts and ingenuity have brought us a huge literature on game theory, on maximization problems in different market settings, on equilibrium paths, etc. However, all of this literature is based on the wrong premise that there are constant relationships between the conditions of action and action itself. The truth is that there are no laws governing *which things* people choose and *which ends* they pursue.[3]

Irrespective of whether one agrees to this apodictical condemnation of the neoclassical approach, the important fact is that this approach is categorically different from what Austrian economists do. The two camps offer entirely different *types* of explanations of observed behavior. The Austrians explain the realized elements of an action (observed behavior) in terms of non-realized elements of the *same* action. Since both realized and non-realized elements are part of the same

[3]We will later explain in more detail why this is so. Among the few neoclassical works which emphasize this problem is the seminal but largely neglected contribution of G.L.S. Shackle (1972). Significantly, Shackle saw no other solution than to pour out the economic-science baby with the theory-of-how-people-choose bathwater.

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action, different aspects of the same fact, they cannot be studied separately. When I read a book, the other things that I could have done, and the purpose that I pursue in reading the book, are *parts* of my action. They are not existentially independent. They are not even real. The only reason to deal with them at all is that they are part of my action, which manifests itself in my behavior and in my thoughts, and that they therefore can be used to explain this behavior and these thoughts.

By contrast, neoclassical economists seek to explain observable phenomena (behavior) in terms of other observable phenomena (behavior of other persons, physical conditions of action) or of psychological phenomena ("degrees of want-satisfaction"). Since all these phenomena are existentially independent from one another, it makes perfect sense to analyze them separately. In particular, it is meaningful to state that an acting person might think that there is something like degrees of want-satisfaction and that, if he maintains such an idea, he might take three attitudes toward any two degrees A and B of expected want-satisfaction. He might think, indeed, that A is greater than B, or that B is greater than A, or they are equal. However, it is an entirely different question whether economic science *must* rely on such considerations, and what kind of economic explanation of the real world *can* be given by referring to them. These questions can be fruitfully discussed by examining Caplan's critique of Austrian economics in more detail, a task to which we shall now proceed.

Indifference Analysis

In his attempt to demonstrate the importance of indifference analysis, and the Austrians' lack of realism, Caplan starts by giving a somewhat imprecise account of why the Austrians reject indifference analysis. The Austrians, says Caplan (1999, p. 825), argue that indifference between two choices A and B is "nonsensical because it cannot be demonstrated in action."

However, it would be more precise to say that Mises and Rothbard consider indifference to be irrelevant for the explanation of human action. The fact is that an acting person always does *something*. This is the starting point for any science of human action. Our knowledge of the existence of choice alternatives and of purposes enables us to explain this fact. Thus when we see that Paul eats ice cream we explain this observation by relating it to possible alternative actions that Paul could have performed. We say that he *preferred* eating ice cream to any other choice he had had. Clearly, this explanation would be impossible if we assumed that Paul were indifferent between eating ice cream and other possible activities. We would still be faced with the undeniable fact that he *does* eat ice cream, but we could not explain it. Paul's psychological indifference is thus particularly unsuited as an account of what he does. And so is indifference in general utterly unsuited as an explanation of what people do.

Caplan (1999, p. 825, n. 3) refers to Robert Nozick's claim that Rothbard implicitly uses indifference analysis when stating that the units of a good are "interchangeable

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from the point of view of the actor" and that "any concrete pound of butter was evaluated in this case perfectly equally by the individual"(Rothbard 1993, pp. 18f.).[4] This is a good criticism of Rothbard's reasoning in this particular case. But it is easy to reconcile the existence of homogeneous goods with the praxeological insight that each of the homogeneous goods has a different value. As Mises stated:

> action does not differentiate between concrete definite quantities of homogeneous means. But this does not imply that it attaches the same value to the various portions of a supply of homogeneous means. Each portion is valued separately. To each portion its own rank in the scale of value is assigned. But these orders of rank can be *ad libitum* interchanged among the various portions of the same magnitude.
>
> If acting man has to decide between two or more means of different classes, he grades the individual portions of each of them. He assigns to each portion its special rank. In doing so he need not assign to the various portions of the same means orders of rank which immediately succeed one another. (1998, pp. 119-20)

Thus, already in 1949 Mises anticipated and elegantly refuted Nozick's criticism. Let us notice that Nozick singled out one passage from Rothbard's work (which is by the way contradicted by many of his other statements) to formulate a criticism on behalf of Austrian methodology in general. Yet, whereas Nozick's non-acquaintance with the Austrian economic literature is explicable, the same excuse does not apply to Caplan who is after all an economist.

Caplan further claims that Mises and Rothbard make "the crucial assumption . . . that all preferences can be revealed in action" (1999, p. 825). This must be a tacit assumption, for Caplan does not quote Mises and Rothbard making it. But, again, the starting point of the Austrian analysis is not a freely floating choice theory, which is then somehow applied to the real world, but real human action. Choice theory refers to the *relations* which link realized and non-realized parts of human action, and when applying choice theory we can thus explain any given activity by relating it to other elements of the same action. We can relate an activity to foregone alternatives ("Paul prefers eating ice cream to all other alternatives") or to purposes ("Paul eats ice cream in order to grow fat and ugly"). In both cases we explain a real-world phenomenon in terms of the relationships in which it stands.

It is against this background that we have to understand Mises's critique of the behaviorist perspective on phenomena like "rush hour at the Grand Central Station." There are no laws relating the behavior of people rushing back and forth to previous or later behavior. However, we can explain their behavior by relating it to the underlying purposes, like getting from home to the train, and from there to work, etc.

Having this in mind, it is easy to give an economic account of the psychic phenomenon of indifference between two events. For example, Paul might be

[4] Nozick's critique is in Nozick (1997). On Nozick see Block (1980).

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indifferent between buying the red or the green sweater. An economic analysis of Paul's action could stress that he *prefers* to be indifferent rather than choose either the red or the green sweater (which implies of course that he does choose a third option—standing around and gazing at the various sweaters). It could also stress that Paul does not choose to buy either a red or a green sweater for a certain reason, for example, because he wants to keep his money or because he wants to deliver a (futile) proof of the importance of indifference in human action. In short, indifference as we know it by introspection is a fact *to be explained*. It is not and, as we have argued, cannot possibly itself be an explanation of human action.

It is also easy to deal with Caplan's counterexample of a preference that is not revealed in action. Says Caplan (1999, p. 826):

> my preference for ice cream at the current instant cannot be revealed, since by the time I managed to find an ice cream vendor the current instant would have passed. Buying ice cream ten minutes from now only reveals a preference for ice cream *then*. And yet, I have introspective knowledge that I want some ice cream right now.

This description of a "non-revealed preference" is interesting only as an account of Caplan's mental state of affairs (that is, of a fact to be explained). But it is irrelevant for the explanation of what Caplan does. It does not tell us *why* he sits in his office and thinks of a "preference" for ice cream that does not materialize in action. Economic science can explain his behavior only by relating what Caplan does to what he might have done instead. It states that Caplan *prefers* to spend his time imagining a satisfaction that he cannot obtain.

CARDINALITY

Caplan sets out to criticize Rothbard's rejection of the theorem that "in equilibrium the rate of the marginal utilities of the various goods equals the ratio of their prices" (1999, pp. 826f.). But, astonishingly, Caplan gives no counterargument whatever. He stresses that one can try to "represent" an agent's preferences by a utility function, and that the same preferences can also be "represented" by any other function that leaves the order of preferences unchanged. This is true. But so what? The crucial fact is that one cannot divide preference ranks by one another and then compare the result to a ratio of prices.

It is obvious that equality between the ratio of marginal utilities (preference ranks) and the ratio of the prices *could* only exist under two conditions. One, if preference ranks and prices had the same dimension (that is, if they were the same kind of thing), then their ratios could undoubtedly be equal. However, this condition is not given since preference ranks and prices are different kinds of things. Thus we are left with two, if both preference ranks and prices were by their nature somehow *extended* so that their ratios would be cardinal, then these ratios could be equal, too. However, this condition is also not given because preference ranks are non-extended entities. One can therefore simply not say how high a preference rank is. One can say that a preference rank A is higher than a preference

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rank B and lower than a preference rank C. That is all. The expression "preference rank A divided by preference rank B" has therefore no cardinal dimension and, as a further consequence, one cannot even *possibly* say whether it equals other ratios.

This is also evident from the problems that we encounter once we try to interpret the meaning of "preference rank A divided by preference rank B." What precisely does the expression "to divide" mean in this context? We venture to submit that nobody can say what it means. It is just as meaningless as "a rabbit divided by a piano concerto," or "a combustion engine divided by a prayer," etc. All we can say about the dimension of "preference rank A divided by preference rank B" is that it *is* "preference rank A divided by preference rank B." But this is obviously an idiosyncratic expression, and since idiosyncratic expressions by their nature have no common denominator there is no possibility ever to ascertain equality between them.

The same problem appears on the side of price ratios. The common view that sees no difficulty in the comparison of price ratios is unwarranted. The problem becomes obvious once we recall that prices are themselves ratios. A price is not just "3 dollars" but rather "3 dollars / 1 hamburger." Now consider the ratios of this price with two other prices, say, "1 dollar / 1 banana" and "2 dollars / 1 coke." The ratio of the hamburger and the banana prices would be "3 bananas / 1 hamburgers," and the ratio of the hamburger and the coke prices would be "3 cokes / 2 hamburgers."

It is clear that we encounter here exactly the same problems as above in the case of ratios of preference ranks (see Hülsmann 1996, chap. 6). The first problem is to interpret the meaning of the different units. What does (banana / hamburger) and (coke / hamburger) actually mean? But the most important problem is that *all these ratios are incommensurable*. They are idiosyncratic just like the ratios of preference ranks. It is impossible to tell whether any number of the dimension (banana / hamburger) is equal to another number of the dimension (coke / hamburger).

Thus the central proposition of neoclassical price theory, that in equilibrium the ratio of the preference ranks of the various goods equals the ratio of their prices, is fallacious in all its parts.

CONTINUITY

Next, Caplan deals with the assumption of continuous supply and demand functions. Interestingly, he makes no attempt to defend this assumption. He does not even try to prove that it is realistic or necessary for certain analytical purposes. His only point is that Rothbard himself uses this assumption and that he therefore cannot object to neoclassical economists who assume the same thing. Caplan observes that the lack of continuity in the demand and supply functions is a strong argument even "against the use of simple algebraic constructs—like intersecting supply and demand lines—that fill Rothbard's works" (1999, p. 828).

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This is a pertinent observation. Yet, if anything, it rather strengthens the case for Austrian price theory.

First, the only purpose of using those simple diagrams is to facilitate communication with neoclassical economists in the first place. And in distinct contrast to his neoclassical peers, Rothbard (1993, chap. 2) applies utmost caution to emphasize that an intersection of supply and demand curves in the real world is an unlikely—although possible—case.

Second, equilibrium has much less importance in Austrian economics than it has in the neoclassical analysis. Mises (1998, pp. 244ff.) emphasized that the *only* role of equilibrium is to help explain *one* component of income, namely, profit and loss. This contrasts sharply with the neoclassical paradigm, in which equilibrium is an analytical panacea that permeates all instances of theorizing about the market. Thus, even granted that Rothbard contradicts himself in attacking neoclassical economists for the continuity assumption, this is but a small contradiction that does not affect the bulk of his work. For the Austrian rejection of the continuity assumption merely implies that market equilibrium (which is of very limited importance in the first place) cannot be *represented* as the intersection of supply and demand curves. By contrast, for neoclassical price theory the rejection of the continuity assumption is fatal, since the very essence of this approach is to describe (that is, represent) equilibrium in terms of algebra and graphs.

Third, and most importantly, Austrian price theory does not depend on the shape of supply curves at all. For equilibrium to be possible it is unimportant whether we can *represent* it as the intersection of curves. Therefore, one can meaningfully speak about profit and loss without any graphical representation that has to rely on unrealistic assumptions like continuity.

A short glance at *Human Action* reveals that Mises's analysis of the market and prices does not make use of curves and algebra. A superficial reader might consider this to be a sign of stylistic conservatism but in fact it relates to the very essence of Austrian price theory. Mises is genuinely uninterested in the questions that absorb the creative powers of neoclassical economists. He does not seek to explain why and under which conditions the actions of the market participants are "coordinated" so that equilibrium results. Rather, the main theme of his chapter on the market is that consumers are sovereign because their buying decisions steer the market (Mises 1998, p. 270). This is true irrespective of *what* consumers buy and irrespective of the reason *why* they make these purchases. Therefore Mises does not deal with the question of what they buy, under which conditions, and why. In his chapter on prices, Mises states that the number of market participants determines *how narrow* the margins are within which prices are determined. Yet, irrespective of the number of market participants, market prices are *always* determined by the decisions of marginal buyers and sellers (p. 324). Thus, all prices can be explained as a result of the mere fact that market participants prefer one good A over another good B (pp. 328f.).

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Income and Substitution Effects

Caplan (1999, pp. 828f) points out that occasionally Rothbard refers to income and substitution effects in his discussion of the shape of demand and supply curves. His criticism that Rothbard, unable to derive these neoclassical concepts from his own utility theory, borrows them on an *ad hoc* basis. It is therefore evident, concludes Caplan, that neoclassical economists gained new and intuitive insights that even Austrians cannot get around.

There are probably few Austrian economists who would claim that nothing of value could be learned *extra muros*. However, Caplan's conclusion is premature. The fact that Rothbard occasionally refers to income and substitution effects does not warrant the claim that these effects correspond to anything real. And it does not make the Austrian theory of the price formation of land and labor dependent on neoclassical insights. We have already pointed out that Mises did not bother about the shape of supply curves or the underlying motivations of market participants. His price theory stresses a much more fundamental feature of price formation, for example, that all exchanges are (at least *ex ante*) beneficial for both parties and that entrepreneurs appraise factors of production in terms of their expected relative contribution to the monetary income generated by the production process. It follows that consumers steer the allocation of resources in a market economy. Nothing of this depends on the shape of supply curves, or on the existence of income and substitution effects.

Uncertainty and Probability

Caplan sets himself the truly heroic task of refuting the opinion that acting man is confronted with non-quantifiable risk.[5] As he (1999, p. 829) states, uncertainty in neoclassical analysis "means that there exists a known probability distribution (objective or subjective) with more than one possible outcome. Choice in the real world of uncertainty is no different from playing a game with known rules and multiple possible outcomes." Caplan notices that in the eyes of Mises this neoclassical "uncertainty" is no uncertainty at all, but must be considered as class probability and sharply distinguished from case probability. Most importantly, human action is genuinely characterized by the unique and therefore non-quantifiable case probability. It follows that the choice of the market participants cannot be adequately described as the outcome of a probability calculus.

Based on a single work on probability theory (Weatherford 1982) and without discussion, Caplan attacks this fundamental distinction between class and case probability by claiming that "*every* event is unique; if quantitative probability does

[5]It was the pioneering achievement of Chicago economist Frank H. Knight (1921) to point out the existence and significance of non-quantifiable risk, which he baptized uncertainty. Mises (1949, chap. 6) elaborated on Knight's distinction between (quantifiable) risk and uncertainty, introducing the notions of class probability and case probability. Today the Austrians are by and large the only standard-bearers of the Knight–Mises theory of uncertainty.

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not apply to unique events then quantitative probability never applies to actual specific situations" (1999, p. 830, emphasis added).

Let us first point out that, *even if* the Weatherford-Caplan thesis were correct, it would be a confirmation rather than a problem for the Austrian approach. It is after all not Mises, but his neoclassical colleagues, who base their theory of choice on a probability calculus.

But can Mises's theory of choice do without quantitative probability? This is a big pill to swallow for economists raised in the neoclassical tradition, and Caplan is obviously incredulous when he states: "Action absent any knowledge of probabilities of different events is hard to conceive. If you could either have $10 with certainty, or $100 with an unquantifiable probability, it is unclear how you would decide" (1999, p. 832).

However, common sense is clearly on the side of the Austrians. Few people outside of economics departments consider it problematic that they cannot quantify the probabilities of future events. The average businessman does not *calculate* his expected future selling proceeds. Rather, he *judges* them to be such and such, and based on this judgment he comes to the market and buys factors of production (see Hülsmann 1997, pp. 46f.). It is not practical people but university professors and other persons with much time to spend on the solution of cognitive puzzles who see a problem here. Let us therefore restate the obvious: human beings act; faced with uncertain and non-quantifiable alternatives they *do* choose one of them. There exists no theoretical problem as far as these facts are concerned. And economic science can explain behavior under uncertainty by relating it to the choice alternatives and to the purposes of the acting person under consideration. A problem emerges only once we venture to determine theoretically how this person *should* choose or how he *would* choose as a corollary of given circumstances. But even if we cannot solve *this* problem—and below we will explain why this is so—this does not prevent us from applying (Austrian) economic analysis. In short, there is no need to solve the problem that Caplan alleges is so important.

Caplan has another argument against the Austrians. Quoting Weatherford out of context, he asks: "could anyone convince a working astronomer that . . . there might be *no* probability that a star is a red giant . . . when we know that many *are* red giants?" (1999, p. 832). Caplan insinuates that this is not meaningful and that, *therefore*, the Austrian denial that probabilities in human action are quantifiable is unjustified. However, this conclusion is unwarranted. Mises admits that events in the sphere of human action have probabilities. He even uses the expression "probability" to describe this fact. Only this probability is case probability that cannot be quantified.

The crucial theoretical question is, of course, *why* there is such a thing as case probability or uncertainty in the Knightian sense. Caplan asks "why should economists believe that any more radical (that is, non-quantifiable) type of ignorance

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exists?" (1999, p. 831). One simple answer is: because as a matter of fact there exists something like genuine novelty and discovery. Israel Kirzner is entirely justified in insisting on this fact, even though he does not explain it in more fundamental terms. But Caplan could have found such an explanation in the writings of Mises and Rothbard, and also in the writings of contemporary economists. Mises (1985, pp. 74ff., 186ff.) argued that the invention of new ideas again and again changes the way human beings act under otherwise equal circumstances. As a consequence, there are no constants but only variables in human action. The very existence of the innovator prevents any attempt to establish regularities of what human beings choose. Rothbard (1997a, chaps. 1–6) argued that man is free to change his mind and act in a different way under otherwise equal conditions.

Recently, Hans-Hermann Hoppe has rigorously demonstrated that any deterministic theory of choice (like the probabilistic approach) implies an inescapable contradiction.[6] He argues that such a theory must presuppose *some* constant relation between the action under consideration (the event to be explained stochastically) and other actions or other events (the conditions under which the stochastic distribution is supposed to exist). This in turn presupposes that man *cannot* learn because any adoption of new ideas would change the way he acts under given circumstances and thus invalidate the regularities postulated by the previous set of probabilities. However, presupposing that man cannot learn contradicts the necessary assumption of any research activity, namely, that research will make a difference. Whoever sets out to develop a model of human behavior necessarily assumes that his findings will have some impact on either his own action or the actions of other persons (otherwise this research would be senseless). If models of past behavior change the behavior of only one person, this will change the conditions of action of all other persons as well. Everybody will sooner or later change his behavior to adapt to the new circumstances, which are brought about by the model of past behavior.

From this it follows that there are no constant relationships between human action and the conditions of action that could be described by stochastic laws. In short, there are no stochastic laws governing human behavior. No human being can therefore base all of his decisionmaking on probabilistic insights. *Ex post* he can classify *past* events in stochastic models, but these models cannot solve the main problem of his decisionmaking, which is to anticipate a unique constellation of the future. Hence, such modeling is also irrelevant for the scientific explanation of human action.

Common sense and theoretical rigor are again on the side of the Austrians.

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[6]See Hoppe (1982; 1989, pp. 112f.; 1993, chap. 7; 1995, pp. 36ff.). For less elaborate statements of the same insight, see also Jewkes (1955, p. 83); Haberler (1963, pp. xiii–xiv); Morgenstern (1976, p. 467); Rothbard (1997a, p. 6); and Popper (1964, p. vi–vii).

It should be noted that Hoppe's critique of the assumption of constant relationships in human action any refers to relationships between *realized* elements of human action. As we have seen, this is not the same thing as to assert that there are no constant relationships in human action at all.

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DEMONSTRATED PREFERENCE, SOCIAL UTILITY, AND WELFARE ECONOMICS

Rothbard bases utility and welfare theory on the principle of demonstrated preference. This principle stresses that one cannot tell what the preferences of an acting person are other than by looking at what he actually does. Caplan sees a problem already on this elementary level. He objects:

> When two people sign a contract, do they actually demonstrate their preference for the terms of the contract? Perhaps they merely demonstrate their preference for signing their names on the piece of paper in front of them. There is no ironclad proof that the signing of one's name on a piece of paper is not a joke, or an effort to improve one's penmanship. (1999, p. 833)

It is true that occasionally it might be difficult to identify a person's purposes by merely looking at what he does. However, Rothbard's point is much more fundamental. Irrespective of all problems linked to the interpretation of people's preferences, these preferences can only be gauged from what people actually do. In short, real human action is a necessary condition for analyzing preferences.

On a more substantial level, Caplan argues that the overall effect of violations of property cannot be estimated in terms of utility without interpersonal comparison of utility. He states: "Since the victim loses and the intervener gains from the application of coercion, it would be impossible to [identify the overall effect on social utility] without a *verboten* interpersonal welfare comparison (1999, pp. 833f.). This is a good point. However, Caplan should have noticed that Austrian economists have recognized this problem before him, and at least one of them has developed a creative solution.

The solution we have in mind is Hoppe's "argumentation ethics," the central claim of which is that only private property can be justified, whereas all arguments in favor of violations of property are necessarily self-refuting.[7] Clearly, any form of social cooperation presupposes *some* kind of agreement, and Hoppe shows that in *all* cooperations, people agree on the existence and respect of individual self-ownership. Even a slave owner uttering a command, by this very command, recognizes that the slave alone actually controls (that is, owns) himself. This is not to say that argumentation ethics postulates that there are no violations of self-ownership. The point is that slavery, murder, theft, robbery, etc. cannot be *justified* without contradiction because any such justification would presuppose that even those who seek to justify murder would have to endorse the principle of self-ownership, lest they would be unable to take part in the debate.

Very similar considerations apply to other pieces of property (apples, chairs, land, music lessons, etc.) that human beings acquire with the help of their bodies. Only those forms of appropriation that respect self-ownership can be justified, whereas all other forms of appropriation contradict self-ownership and, therefore, the necessary basis of social cooperation. For example, homesteading can be

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justified because the homesteader transforms an unowned piece of land with his body (which he owns) and thereby makes it an extension of his self. By contrast, using land without the consent of its homesteader-owner cannot be justified any more than violations of self-ownership can be justified, for the very reason that the homesteaded land is an extension of the homesteader himself.

And so no violation of property can be justified because in every single case it does not respect self-ownership, which is the necessary ingredient of any cooperation. Violations of property might occur in pure forms such as murder. Or they might exist side by side with social cooperation, partially obstructing it, as in the case of a slave economy. Yet in all cases, by their very nature, they contradict life in society.

Let us briefly indicate how these insights can be applied to create the foundations of an Austrian welfare theory that does not rely on interpersonal utility comparisons. In order to apply argumentation ethics to welfare economics, we merely have to realize that all welfare theories deal with action *within the framework of society*. No welfare theorist has ever tried to take account of the welfare effect of human action on monkeys, or of the welfare effect of the behavior of ants on human beings. Now, as Hoppe has shown, invasions of private property have to be rejected as incompatible with the factual prerequisites of social interaction. In short, private-property rights serve as a filter to distinguish actions that are part of life in society from those which are incompatible with civilized intercourse. A violation of property *is* no social behavior, but a partial obstruction of society, comparable to the onslaught by a wild animal. From this it follows that only those actions that are compatible with life in society can possibly be the subject of welfare-theoretical considerations. And violations of property must diminish social welfare below the level it would otherwise have reached, since there is now less civilized intercourse taking place.

Such are the outlines of a consistent welfare theory that is based on demonstrated preference and a theory of justice, However, Caplan contends that another route is more fruitful. He thinks that welfare economics can build on the criterion of Pareto-superiority; that is, from the idea that reallocations are efficient as long as they are potentially Pareto superior. Says Caplan:

> While justice and efficiency are not the same, this criterion . . . has many advantages over Rothbard's approach. In particular, it allows one to make efficiency judgments about the real world—to judge, for example, that Communism was inefficient, or rent control is inefficient, or piracy was inefficient. (Caplan 1999, pp. 834f.)

However, Caplan does not explain how and why efficiency judgments are possible. In particular, Caplan fails to address Rothbard's (1979) argument that the crucial question is *for whom* Communism, rent control, or piracy are efficient and inefficient. A communist leadership might consider Communism a very efficient

[7]See, in particular, Hoppe (1989, chap. 7; 1993, pt. 2 and appendix).

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way to legitimize all-around government planning. Certain politicians might see rent-control laws as an efficient way to promote their careers, and rent control might also be efficient from the point of view of current tenants.

The term "efficiency" refers to the relationship between means and ends. One cannot tell whether a means is efficient without considering the end to be reached. But ends are always the ends of individuals, and in political questions (Communism, rent controls, etc.) these individual ends are *always* conflicting. Therefore, one cannot say whether a disputed policy is efficient. All one can state is that it is efficient for some persons and inefficient for others.

There are but two possibilities to overcome this problem. The first one is to make inter-individual comparisons of value. If the efficiency of a policy for one person is greater than the inefficiency of the same policy for another person, one could argue that the policy increases overall efficiency in the economy. However, neither Caplan nor any other author has demonstrated how such comparisons can be performed. In particular, nobody has solved the problem of comparing non-extended entities like value, utility, preference ranks, etc.

Thus one is led to the second type of solution, which consists in abandoning all attempts at building welfare economics on the theory of value and to look for other foundations. This is where Hoppe's theory of justice comes into play. Presently, that is, as long as nobody solves the problems of the value-theoretic approach, this seems to be the most promising route for welfare economics.

Public Goods

The Austrian view of the public-goods problem is based on three arguments. First, there is no way to judge whether people really want a good, and how much they want of it, other than by looking at their actions. It is therefore unwarranted to call for government action to provide a good that otherwise would not be produced in sufficient quantities. If people are willing to sacrifice enough of their resources, any good can be produced without government intervention.

Second, there is no criterion by which public goods can be distinguished from private goods. This difficulty arises on a level that is even more basic than the common definition of public goods, which stresses non-rivalry of consumption and the impossibility to exclude other users. Fundamentally, a good can possibly be a public good if it brings about desired or undesired effects on people different from its owner (externalities). Yet, these externalities are clearly not a feature of a good as such, but depend exclusively on the subjective feelings of those other people. Whenever any person other than the owner takes an interest in a good, it becomes *ipso facto* a public good. As a consequence, there is no means to clearly distinguish between public and private goods. All goods can be public goods. And even more awkward is the implication that the status of a good can change from one second to the next by mere subjective whim (see Hoppe 1993, pp. 7f). This makes the criterion of "being public" unsuited as a basis for policymaking on behalf of the good.

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Third, even if a good could properly be identified as a public good, it would not follow therefrom that government should provide it. In other words, it would still be necessary to justify state activity by a separate normative argument.

Caplan criticizes this theory on two accounts. He observes that "the argument follows from Rothbard's utility theory [which] as previous sections argued, is mistaken" (1999, p. 835). However, for reasons outlined above, Caplan's objections against Rothbard's utility theory miss the point.[8] We can therefore proceed to Caplan's second admonition. He claims that

> Rothbard's *a priori* rejection of the concept of public goods was simply the wrong *route to take; it would have been more productive to point out the public goods* problem of government along with the surprising ability of free markets to supply voluntary solutions to genuine public goods problems. (1999, p. 836)

Now, it is necessary to remind oneself that the original purpose of public-goods theory was to establish a rational criterion for government intervention. The whole point of the public–private distinction was to delimit the conditions under which it is useful or necessary that government takes action. Clearly, against *this* background Rothbard's *a priori* rejection of the public-goods concept makes perfect sense, for the concept does not fulfill the role it was promised to play in the first place.

Seen from the present state of public-goods theory, which admits the possibility of government failure to produce public goods, the whole debate has become pointless. If government *and* market can fail to produce public goods, then public goods are no relevant subject for policy-oriented research at all. Rather one has to come up with *other* criteria that could fulfill the role of delimiting a field for government activities. The analysis of these criteria would then be a truly relevant occupation for economists. Caplan is apparently unwilling to draw this conclusion. His suggestion "to point out the public goods problem of government along with the surprising ability of free markets" is symptomatic of the present lamentable situation in which economists consume their energies in self-serving "analyses" without practical import.

Conclusion

A sober look at the assumptions underlying neoclassical analysis reveals that they are either not realistic (continuity, cardinality, etc.) or not applicable in economic analyses of the real world (for example, psychological indifference). And pre-Caplan neoclassicists hardly ever claimed that they were. Insofar as mainstream economists cared about realism at all, they maintained that their assumptions were a useful approximation of reality and that, in any case, there was no better alternative theory.

[8] *Even if* Rothbard's utility theory were mistaken, it would not follow, as Caplan claims, that the Austrian theory of public goods would *therefore* be wrong. I am indebted to David Gordon for this point.

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It seems clear, however, that such a better alternative exists in the Austrian approach insofar as it can rely on the work of Mises and Rothbard. This is not to say that these two authors have led our science to a state of perfection. But that they have pointed out a thoroughly realist approach toward the economic analysis of our world cannot be denied.

This approach is hardly an "uncharted alternative," as Caplan (1999, p. 837) claims. The mainstream of economists still has to absorb the lessons contained in the collected works of Mises and Rothbard, and this alone will take a while. Moreover, it is a matter of fact, even if Caplan ignores it, that many contemporary economists have made substantial contributions that rely in their best parts on the Misesian framework. For example, in monopoly and price theory: Selgin (1988a), Block (1990), Salin (1996a,b), and Armentano (1999); in comparative economic systems: Hoppe (1989), Salerno (1990a), and Huerta de Soto (1992); in welfare theory: Sennholz (1987), Thornton (1991), Cordato (1992), and Herbener (1997); in industrial organization: Klein (1996); in money and banking: Salin (1982; 1990), White (1989), Selgin (1988b), Hoppe (1994), Huerta de Soto (1998), and Nataf (1997); in public-goods theory: Hummel (1990) and Holcombe (1997), and Campan (1999); in the theory of the entrepreneur: Kirzner (1973; 1992); in public-choice theory: DiLorenzo (1988); in the theory of privatization: Salerno (1982), Hoppe (1991), Herbener (1992), Selgin (1996). These are only examples, and they refer only to the field of theory. Contemporary Austrians have made substantial contributions also in methodology, in the history of thought, and in applied work.

The very existence of these works counters Caplan's concerns that the time might not yet be ripe for a paradigm shift. The truth is that economic science, if it develops at all, will have to shift to the great tradition of realist analysis which the Austrian economists helped develop for more than hundred years and of which they are currently the only representatives. Future economists will have to become Misesians just as today's astrophysicists had to become Einsteinians.

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AUSTRIAN THEORIZING: RECALLING THE FOUNDATIONS

WALTER BLOCK

It is a pleasure to reply to Caplan's (1999) critique of Austrian economics. Unlike other such recent reactions[1] this one shows evidence of great familiarity with the Austrian (praxeological) literature, and a deep interest in its analytical foundations. Thus, Caplan correctly identifies the works of Ludwig von Mises and Murray N. Rothbard as the core of what sets Austrian economics apart from the neoclassical mainstream. And he insightfully relegates the writings of F.A. Hayek and Israel M. Kirzner to an intermediate position between the praxeological and neoclassical approaches.[2]

We shall defend this core of Austrian economics against Caplan's criticisms, and show that, just as in the case of these others, his arrows fall wide of their mark. It is nevertheless instructive to highlight his errors. The benefits are a better understanding of the Austrian School, and greater insight into neoclassical shortcomings. This article follows the outline of Caplan (1999) and is divided into the same four sections as his: first an introduction, second, consumer theory, third, welfare economics, and fourth, a conclusion.

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[1]See in this regard Rosen (1997), Tullock (1998), Timberlake (1987), Demsetz (1997), Yeager (1987) and Krugman (1998). For a reply to Rosen (1997) see Yeager (reply to Rosen); for a response to Yeager (1987) see Block (1988), and also Yeager (1988); for a rejoinder to Tullock (1988), see Salerno (1989) and also Tullock (1989); for a reaction to Timberlake (1987) see Rothbard (1988) and also Timberlake (1988); for an answer to Krugman (1998) see Garrison (1999); for the Block–Demsetz debate, see Block (1977), Demsetz (1979), Block (1995), Demsetz (1997) and Block (forthcoming).

[2]More recent studies by Austrian economists confirm this point of view. See in particular Salerno (1990; 1993), Rothbard (1997, chap. 7), Hülsmann (1997).

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CONSUMER THEORY[3]

Indifference

"Indifference," for the Austrian School is a technical word. We deny that indifference is compatible with human action, the attempt to render the world a more preferable place than would have occurred had no such act taken place. Were a man truly indifferent between state of the world A (the one which would ensue without his intervention) and state of the world B, he would not act so as to make the latter more likely.

We do not deny, however, that "indifference" also has a perfectly reasonable usage in common parlance. In ordinary language, a person could be readily understood to be indifferent between wearing a green or a blue sweater. This means that he doesn't care much which one he chooses. Given that he will only wear one of them at a time, and chooses the green, he is still reckoned, speaking loosely, to be indifferent between them, because we can readily imagine him picking the other.[4]

But if we were to "get technical" about the matter, it would be at the very least extremely puzzling for a man to select the green sweater in preference to the blue if he were truly indifferent between them. Indeed, this would be nothing less than a logical contradiction. If indifference were his exact mental state, surely he would select neither article of clothing. As in the case of Buridan's Ass, who avoided both piles of equidistant hay, he would eschew both sweaters.[5] Very much to the contrary, if when presented with both the person selected green instead of blue, we as outside analysts, or economists, would be entitled to infer from this act a preference for green.

But Caplan is having none of this. He states (1999, pp. 825–26):

> The crucial assumption—shared by both Mises and Rothbard—is that all preferences can be revealed in action. But why assume this? . . . I have all sorts of preferences that are not—and cannot be—revealed in action. For example, my preference for ice cream

[3]Caplan (1999, p. 825, n. 3) mentions Nozick (1997) as presenting "different but complementary arguments against Mises's and Rothbard's utility theory and rejection of indifference analysis." This was replied to by Block (1980).

[4]In similar fashion, other academic disciplines also utilize ordinary words and invest them with technical meaning. For example, the physicist means one thing by "work," (e.g., force times distance), while the man in the street means something somewhat different. Were a weightlifter to hold two 50 lb. barbells with extended arms, shoulder height, he would not be doing any "work" in the strict sense. However, sweat would soon be seen to pour off his brow; he would be "working" very hard indeed in the ordinary language definition of that term.

[5]In Rothbard's (1993, pp. 265, 267) view,

> If a man were really indifferent between two alternatives, he could not make any choice between them, and therefore the choice could not be revealed in action. . . . Buridans ass . . . is confronted not with two choices but with three, the third being to starve where he is. Even on the indifferentist's own grounds, this third choice will be ranked lower than the other two on the actor's value scale . . . the ass or the man will allow pure chance, such as a flip of a coin, to decide one either (bale of hay).

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> at the current instant cannot be revealed since, but the time I managed to find an ice cream vendor, the current instant would have passed.

Strictly speaking, Caplan's ice cream example cannot be used to reject Rothbard's claim "that all preferences can be revealed in action." Rothbard's argument is that only demonstrated preferences are "genuine" for economic theory, i.e., related to action. Pie in the sky "wishes" that a person has (e.g., to buy ice cream without money, or to purchase it "later") are not preferences at all in the technical sense. Preference is defined, in this technical sense, as the ranking of ends upon which an action is based. This is what makes Caplan's claims about acting on the basis of indifference incorrect.

Using Caplan's exact words, his preference for ice ream *can* (at least sometimes) be demonstrated: at least on those occasions when we catch him in the instantaneous act of making a purchase of this foodstuff. True, it cannot always be so demonstrated. At the precise point of time I am writing these words, Caplan may again be wishing he had some ice cream, and yet, not be in a position to purchase any. *This* preference of his, assuming he now has it, is not revealed by action, but it *could* be, as we have seen, so it is false to claim that it "cannot" be. The point is, however, that this "preference" in the absence of human action is not a *demonstrated* preference. It will do, fully, for ordinary discourse, as in the case of indifference. (This is why we can understand what Caplan is getting at.) But as far as technical economics is concerned, we cannot take cognizance of those of Caplan's wishes which are not objectively revealed or demonstrated in action. How can we, as economists, even know they exist?

Our author's second sally (1999, p. 826) is "One can only observe that I choose a green sweater, but this does not rule out the possibility that I was actually indifferent between a green sweater and a blue sweater." In common parlance, we are certainly prepared to accept Caplan's introspection on the matter. Presumably, he has no strong preference for the one color over the other. But as a matter of technical economics, we are hard put, on the basis of indifference, to account for the fact that he did indeed pick up and put on the green sweater, when he could have had the blue. Perhaps the green one was on top of the blue, and some slight additional effort would have been necessary to wear the latter; perhaps they were side by side, but at the last minute, even thinking he was fully indifferent, he veered toward the green based on a very slight, perhaps even unconscious preference. All we know is that he dug into his sweater draw, and came up with the green one. What else are we to infer but that he preferred his color?

Consider the implications of accepting Caplan's position on indifference. First, it is nothing short of the rejection of the elementary claim that economic action is an attempt to substitute a more desirable state of affairs for a lesser one. But this would render incoherent all purposeful human activity, to say nothing of all of economics. It is an undeniable (e.g., praxeological) fact that people act so as to improve their position, not to move from one state of affairs to another, where both are in all respects identical. Why would anyone bestir himself if there were

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absolutely no gain in it for him? Caplan is confusing definitions. He is claiming that a man can act when in the *psychological* (or non-technical from an economic point of view) state of indifference. Well and good. But Rothbard, in contrast, is claiming that man cannot act in the *praxeological* state of indifference. This two are not incompatible. *Both* could be true. Thus Caplan never lays a glove on Rothbard in this regard.

Even Caplan, in his attempt to deny this primordial reality, is himself snared in its clutches. For this George Mason economist is not indifferent between the Austrian (anti-indifference) and the neoclassical (pro-indifference) theories. Rather, he prefers the latter to the former, and offers reasons, to the best of his ability, why the still undecided members of the profession should cleave to his own views. From this we can make certain inferences. But what would follow were he truly (e.g., praxeological) indifferent to these two viewpoints? Nothing. Caplan could attempt to reply on his own grounds that he is indifference between the Austrian and neoclassical positions and yet, still wrote his (1999) paper. But this would not be true on technical grounds. This would be a very strange way indeed to demonstrate praxeologically he is indifferent between the two views.

A second implication has to do with public policy. Consider taxation. Under the Austrian interpretation, we are in a position to assert without fear of contradiction that this must worsen the economic position of the taxpayer. For, if he had wanted the government to have his money, he would have rendered it to Caesar. But he did not undertake any such activity on a voluntary basis. Instead, he did so under threat. He was made to accept a state of the world less preferred (one where he paid taxes) to one more preferred (one where he kept his funds for himself). Under Caplan's perspective, we can no longer reach any such conclusion. Now, it is entirely possible that the citizen was indifferent between the two situations. Take another example: trade. Austrians are in a position to deduce from voluntary trade that both parties to it gained utility, at least in the *ex ante* sense. For Caplan, it might be that one of the trading partners, or, even, neither of them, made any gain in utility; that, instead, trade really is a zero-sum game, as our friends the socialists are wont to claim.

The Austrian takes a position midway between that of the behaviorist and Caplan's neoclassicism.[6] For the behaviorist, there is no such thing as motive, introspection; all is human behavior. For Caplan, all is motive and introspection; no behavior whatsoever is necessary to tie these phenomena to the real world. In the praxeological perspective, there is both, and the latter is necessary to demonstrate the former.

Cardinality

The Austrians are clear on the matter of ordinal vs. cardinal utility. The former is a basic building block of economic theory, the latter is a snare and a delusion. There are units for weight (pounds), height (inches), distance (miles) and even

[6]For the view that the Austrian School in general occupies a "middle ground," see Garrison (1982). See also Block (1997, 1998ab).

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temperature (Fahrenheit), but this simply does not apply to happiness or utility. Contrary to mainstream economics, there are no utils; there is no way, scientific or even commonsensical, to measure joy. There is only preference and setting aside; that is, ordering different goods, or units thereof.

Caplan sees this full well. Instead of embracing the Austrian perspective on this matter, however, he tries to have his cake and eat it too. That is, he maintains that the neoclassicals, too, eschew cardinality in favor of ordinality. So intent is he upon showing the flaws in praxeology, he insists on vesting the mainstream with the Austrian view when he cannot quite bring himself to a direct rejection of its doctrine. He (1999, p. 827) states:

> While the exposition of utility theory in undergraduate textbooks may sometimes be open to Rothbard's critique of cardinality, neoclassical utility theory is no less ordinal than his own theory [see, e.g., Varian, pp. 95–97]. Let a neoclassical theorist say "bundle one offers utility of 8, while bundle two offers utility of 7," and Rothbard concludes that he believes in cardinal utility. But . . . the meaning of [this claim] . . . is nothing more or less than "bundle one is preferred to bundle two."

This really will not do.[7] First of all, even on his own assumptions, Caplan must explain away the fact that neoclassical "undergraduate textbooks sometimes" employ cardinality. Texts are, presumably, the distillation of the learning and teaching of the subject matter. If they "sometimes" utilize cardinality, this is *prima facie* evidence that so does the profession as a whole. Where there is textbook smoke, there is professional fire. In contrast, the obverse criticism cannot be made. That is, by definition, there is not, there cannot be, any Austrian text which indulges itself in cardinality.

Second, no one disputes that mainstream economics *also* engages in ordinal analysis. Certainly, neither Rothbard nor any other Austrian would reject this claim. The problem, for the praxeologists, is that the traditionalists credulously accept, as well, cardinality. Thus, "neoclassical utility theory is no less ordinal than" Rothbard's "own theory" in the weak sense that it, too, employs ordinality. But mainstream utility theory is certainly "less ordinal" in the sense that it dilutes itself with more than a vestige of cardinality.

Third, this is by no means limited to a few, in effect, renegade neoclassical textbooks. The cardinality error is deeply embedded in neoclassical economics. It pervades virtually all relevant analysis. Every time we see the equation:

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[7]We are unable to find the statement in Varian (1992, pp. 95–97): "bundle one offers utility of 8, while bundle two offers utility of 7," means only that "bundle one is preferred to bundle two." However, in support of Caplan, Varian (p. 95) does state: "The only relevant feature of a utility function is its ordinal character." On the other hand, the two are not precisely equivalent. It is conceivable that in Varian's view, utility can be both ordinal and cardinal, and that the latter is irrelevant. But just because Varian makes this statement, does not mean that we, or he, takes it seriously. Varian (p. 97), for example, differentiates utility. How is this possible if utility is purely an ordinal construct? It is interesting that Caplan cited only one author to the (rough) effect that utility is only ordinal, not cardinal. This is surely idiosyncratic for a neoclassical. There are dozens of other texts which take the opposite perspective.

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$$\frac{MU1}{P1} = \frac{MU2}{P2}$$

and we see this *all* the time, there is cardinality at work. For it is impossible to divide ordinal numbers, e.g., 5th, 2nd, 1st, 9th, by anything else.[8] When a utility variable is divided by something else, you can be sure that the numerator is couched in terms of cardinal, not ordinal, utility. Further, all of "cost-benefit" analysis is no more than a futile exercise in cardinal mongering; even worse. For here, in addition to engaging in the unscientific measuring of an individual's utility, these cardinal values are then interpersonally compared. And the same holds true in the analysis of externalities, to say nothing of the "proof" that "imperfect competition" is economically inefficient.[9] Thus, cardinality lies at the very root of neoclassical economics; indeed, this is one way to distinguish the Austrian School from the mainstream.[10]

Fourth, it is rather ingenuous to interpret the statement "bundle one offers utility of 8, while bundle two offers utility of 7," as "nothing more or less than 'bundle one is preferred to bundle two.'" Twist and turn as Caplan will, the plain meaning of the statement is that bundle one is 14 percent more valuable than bundle two, surely a cardinal claim. Were Caplan correct in ascribing ordinality to this claim, the very opposite ranking would ensue.[11] That is, the one ranked 7, or 7th, would be ranked higher than the one ranked 8, or 8th. Surely the runner who crosses the finish line in 7th place has beaten the one in 8th.

Continuity

It is indeed true, as Caplan (1999, p. 828) asserts, that for the Austrians, human action occurs in a discrete manner. Creatures such as ourselves cannot make infinitesimally small distinctions. Since mathematical economics relies on differentiation, and this implies smoothness of curves, this, too, must be discarded if economics is to be based on rational foundations.

Our author has several criticisms of this praxeological principle. First, there is the view that "the unrealism of continuity is only minor"; why throw out the mathematical

[8]If this equation is interpreted merely as a ratio, or an analogy, it might be possible to defend users of it from the charge of cardinality. However, as mathematical operations are commonly conducted with this equation, this is not possible. (I owe this point to David Gordon).

[9]Friedman's (1962, chap. 12) negative income tax is also predicated upon this idea.

[10]It would be an embarrassing and neverending task to document the cases where neoclassicals employ cardinal utility. Let us content ourselves with only two. Musgrave (1959, p. 97; see also Musgrave, Musgrave, and Bird, 1987) is as venerable an example of mainstream thought on this matter as can be desired. In his figure 5-1, he places income on the x axis, and both "marginal utility" and "total utility" on the y axis. Now, what kind of utility could this be: ordinal or cardinal? To ask this is to answer it: only cardinal utility can meaningfully be placed on an axis. Similarly, consult Varian (1992, p. 104, figure 7.3), cited by Caplan as maintaining the premise that utility is ordinal, not cardinal. He, too, places utility on the x axis, and income on the y axis.

[11]I owe this point to David Gordon.

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economics baby just because of a slight problem with the continuity assumption bathater? But the problem here is that differentiability has profound implications for economics, which could not have been deduced in its absence. It is not merely a useful heuristic device, allowing us to translate economics into a more elegant language, and certainly not one which generates insights which are both new and true.

Consider as an example the oft repeated anti-"monopoly" canard that, facing a downward sloping demand curve generated by "imperfect competition," the firm cannot locate its operations at the bottom point of the average cost curve (fig. 1).

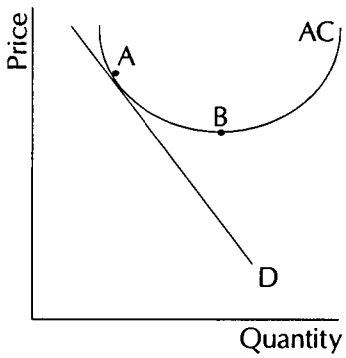

Figure 1

Here, the firm facing a downward sloping demand curve produces at point A, more costly than at point B, which is attained by the "perfectly competitive" firm facing a horizontal demand curve.[12] But this "insight" does not necessarily follow from the downward slope of the demand curve[13]; on the contrary, the continuity assumption of the cost curve is also required. This can be shown by depicting the familiar "u" shaped cost curve[14] in two different non-continuous versions. In each of these cases (fig. 2) a downward sloping demand curve is depicted as compatible with attaining the low point A on the average cost curve.

Second, Caplan (1999, p. 828) attempts a *reductio*. If human beings are not constructed so as to be able to register infinitely small changes,

> then it will also be impossible for humans to see . . . infinitely small steps of a given monetary unit. But with a discrete good and a discrete monetary unit, it is unlikely that supply and demand will ever be equal; no equilibrium price need exist. Excess demand may be -2 units when the price is $1.01 and +1 unit when the price is $1.00.

[12]There are no end to the texts which feature this diagram, or to the journal articles which rely upon such analysis; however, we only cite one: Rothbard (1993, pp. 638, 642).

[13]For a distinctively Austrian approach to this matter, see Rothbard (1993, p. 644)

[14]Such apparatus is not employed by Austrians not because they are not familiar with the "modern tools of economic analysis." This is, rather, due to the fact that praxeologists take seriously the notion that the true meaning of costs is alternatives or opportunities foregone, and that these are subjective phenomena, available only to the human actor himself. On this see Rothbard (1993); Buchanan and Thirlby (1981); Buchanan (1969, 1979); Buchanan (1982); Mises (1966).

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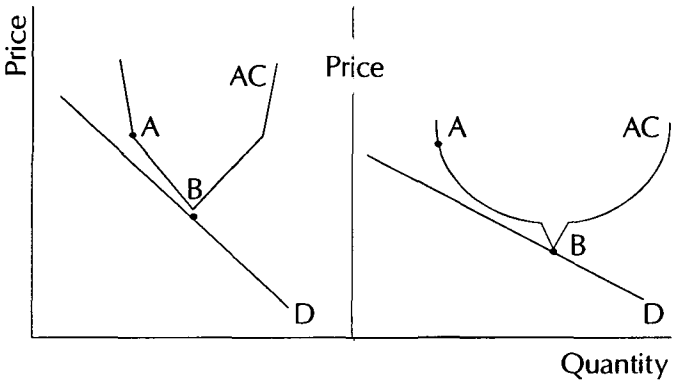

Figure 2

This would indeed be a compelling argument were it launched against neoclassical economics, which focuses on equilibrium, which places this construct at the center of its universe, which lives or dies with it; but not against an economist such as Rothbard. For these two do not contend, and need not since preferences are ordinal, that market clearing equates the utility of the marginal buyer with that of the marginal seller. For them, all the mutual benefit of trade can be exhausted even if the marginal utilities are unequal. As well, equilibrium plays a far lesser role in Austrianism than it does for the mainstream. Here, equilibrium is merely a direction towards Caplan writes for empirical support[15] for the contention that the mainstream is overwhelmingly concerned with reiterating the trite. For example, Lee (1999) once again shows the Public Choice School as dedicated to supporting socialism and state invervention[16]; Doyle, Ahmed, and Horn (1999) testify that the doctrine of opportunity costs does indeed apply to crime; Robson and Wren (1999) formally indicate that tax incentives apply to self-employing choices; Goodman, Stano and Tilford (1999) geometrically demonstrate that prices apply not only to the choice between leisure and income, but also to the allocation between health and non-health goods; Granderson (1999) expresses the view that economic regulation lowers technological improvement and raises costs; Herander and Kamp (1999) reiterate that quotas interfere with trade; Arrighetti and Vivarelli (1999) apply the notion that greater skills tend to be correlated with greater economic success; and Hwang Mai (1999) wax eloquent about optimal export taxes. [17]

[15]As a neoclassical, Caplan should appreciate this.

[16]For support of this contention, see Rothbard (1997, pp. 269–74); Block and DiLorenzo (forthcoming).

[17]We don't include under this rubric the fact that Long (1999) shows that high marginal tax rates reduce taxable income; and that Shughart (1999) supports Lott's (1998) unexceptionable point that economic incentives apply to gun control legislation. These, too, are but implications of basic economic theory, but they are very distinct from the others in that they tend to support economic freedom, a rarity in mainstream economics.

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Uncertainty and Probability[18]

This is the weakest section of Caplan (1999). If there is anything about which one would have thought mainstream economists ought to be modest, it is prediction. Where are now the one time much vaunted econometric models which were to prognosticate the future of economic events? After numerous signal failures, they have pretty much been consigned to the dustbin of history.

Caplan defends neoclassical pretentions to knowledge, at least of the class probability variety. He taxes the Austrians for being unduly pessimistic about the prospects of information availability regarding class probability, without which there cannot be even the possibility of scientific prediction. We may not know everything, but at least we, as an economics profession, can remain secure as regards the behavior of entire classes of economic events, in his view.

In contrast, he maintains, the Austrians, particularly Mises and Rothbard, restrict the scope of class probability to dice, coin flipping, poker, lotteries, and other such games of chance. As for the future pattern of economic considerations such as demand, supply, cost, resource availability, etc., the best that can be said for them by the Austrians is that we know something, but far from all about them, and their class probabilities.[19]

On the basis of these considerations, Caplan (1999, p. 830) attempts a *reductio ad absurdum*:

> every event is unique; if quantitative probability does not apply to unique events, then quantitative probability never applies to actual, specific situations . . . Even in games of chance, all draws and throws are "individual, unique and nonrepeatable." Dice are always rolled at a particular time and place, in casinos of varying honesty, so we never "know nothing but that they are elements" of the class of dice. Additional information inevitably accompanies every real case. Unless the probability of some unique events can be quantified, Mises seems forced to deny that probability can ever be quantified.

Even were this *reductio* to succeed, at worst it only attacks the minor Austrian point: that class probability does apply in a limited way to human events, pre-eminently to those concerning games of chance. Were the Austrians to concede this point to Caplan, this would create not even a fissure in its foundations. It all depends upon just how "dishonest" are the roulette wheels. If only slightly so, then class probability would still apply; it can be utilized for all types of insurance and industrial processes, e.g., defective bolts (Rothbard 1993, pp. 498–501), and there is no reason to suppose that only slightly dishonest gambling tables would be actuarily less predictable than these events. On the other hand, with seriously dishonest games, all bets would be off; both in terms of the

[18] I am indebted to Guido Hülsmann in the section.

[19] For the Lachmannites (Lachmann 1976; Vaughan 1994; Lavoie 1985) who do not deserve to be counted as Austrians, certainly not of the Mises and Rothbard stripe, matters are far worse. Here, not only is there not class probability, one wonders whether there is even case probability.

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likelihood of people patronizing them, and of our ability to apply class probability to them.

But Caplan's analytic framework fails even to address the major Austrian contention of Mises and Rothbard, to wit, that class probability cannot be made to apply to most economic events. *This* is the crux of the failure of neoclassical economics to make good on its exultant promise to predict the future. As long as there is free will, as long as people are "free to choose," prognostication is a chimera. Even if their past acts could be accurately characterized by a normal distribution, or accorded with some specific elasticity or another, this does not at all warrant the assumption that they will continue to do so in the future.

Let us put this into different words. Caplan does not even try to prove his case. All he does is to insinuate that the neoclassical approach (which denies case probability) makes more common sense than the Austrian (which emphasizes its existence). Clearly, this kind of "discussion" will not satisfy the disinterested observer.

In particular, Caplan fails to address the central question in this field, namely, whether it is at least conceivable that all decisions can be modeled *as* stochastic events, or as *based on* a stochastic model of the world. In short, the crucial question is whether human action can be entirely determined, and on which conditions such a determination depends. Mises (1966, chap. 9; 1985, pp. 74ff., 186ff.) discusses these issues at length, the latter work of which Caplan largely ignores. Mises argues that the emergence of new ideas necessarily overthrows all previous patterns of behavior and, therefore, all economic models based on past data. The only way to get around this problem would be to explain how physical and chemical events determine the emergence of new ideas. But since nothing is known about this process, economists have to plead ignorance, and accept that human beings are confronted with unquantifiable probability (Knight; Mises) or, in other terminology, sheer ignorance (Kirzner).[20]

Reconstructing Welfare Economics

Demonstrated Preference, Social Utility, and the Coordination Norm

Caplan correctly cites Mises and Rothbard to the effect that economic transactions benefit both parties at least in the *ex ante* sense, and that since the market is just a name for the concatenation of all such events, we may deduce that it benefits all participants.

But then, he gets into trouble when he attempts to paraphrase their views. He states (1999, p. 833): "This claim might be rephrased to say that each voluntary exchange benefits all participants and the free market permits the implementation of all desired voluntary exchanges."

On the basis of this interpretation, Caplan (1999, p. 833) pounces:

> While this conclusion appears to be a simplistic non sequitur, it follows immediately from his unusual utility theory. For Mises and Rothbard, it is simply confused to posit

[20]For more on class vs. case probability, see Hoppe (1997).

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> latent preferences; if two individuals fail to make an exchange, then this *ipso facto* demonstrates that at that moment at least one of them would not have benefited from the exchange.

Simplistic non sequitur? On the contrary, this is one of the basic building blocks of all of economics. If voluntary trade is not mutually beneficial, economics as a science (at least the Austrian variety) is doomed. Of course the free enterprise system only *permits* the implementation of all desired voluntary exchanges, this is a far cry from *guaranteeing* any such outcome. Caplan appears to assume the latter, however. It is perfectly possible for there to be a failure to communicate. Just because all trade is mutually beneficial does not mean that "if two individuals fail to make an exchange, then this *ipso facto* demonstrates that at that moment at least one of them would not have benefited from the exchange." Both *could* have benefited, if only they had but known of each other.

But what of third party effects, much beloved by mainstream economists? Rothbard gives the back of his hand to those who claim their envy vitiates the benefits-from-trade claim. For these busibodies have no way to definitively *demonstrate* that the gains to the trading partners are more than offset by their own losses. Indeed, they have no way to prove they lose out at all.

But this does not satisfy our author. Instead, he (1999, p. 833) launches another *reductio ad absurdum* at Rothbard. If envy cannot demonstrate loss of welfare, well, then, neither can the signing of a contract by two people

> actually demonstrate their preference for the terms of the contract. Perhaps they merely demonstrate their preference for writing their name on the piece of paper in front of them. There is no ironclad proof that putting one's name on a piece of paper is not a joke or an effort to improve one's penmanship.

Caplan is making an error here similar to the one he made about indifference. Austrians do not deny that both indifference and envy have a role to play in ordinary parlance. Both concepts can be used correctly, or misused. There *is* such a thing as envy, and only a pure behaviorist (or philosophical skeptic) would be inclined to doubt it. But Rothbard was speaking praxeologically, not as an ordinary language philosopher. Rothbard (1993, p. 18), specifically cited by Caplan (1999, p. 833), states: "A person's 'envy' unembodied in action, becomes pure moonshine from a *praxeological* point of view" (emphasis added).

Compare and contrast the "skepticism" evinced by Rothbard and Caplan. The former doubts that C, the envious person, can demonstrate that he loses utility when A and B trade, certainly that this loss more than offsets their gains.[21] The latter doubts, in effect, that people can agree to trade at all, since their efforts to demonstrate this may be a mere exercise in penmanship. If we took cognizance of the former doubt, the world would be much the way it is, except that a good bit of economic regulation and government interference with market choices would

[21] Given that interpersonal comparisons of utility are invalid.

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disappear. If we incorporated the latter into public policy, the economy would grind to a halt and most of the world would quickly die. Without property rights and the ability to transfer them (contracts) few would survive. Is the choice, as Caplan would have it in his *reductio*, between almost complete skepticism, and slavish devotion to the claims of the envious person? No. Again, Austrianism occupies a midground of sanity between these two extremes.

Further, in his retort about "penmanship," Caplan fails to come to grips with the Austrian notion of understanding, or *vershtehen*. The economist must *interpret* human action; he must "get into the mind" of the economic actor. For example, what, exactly, is going on in Grand Central Station during rush hours? Is it a magnificent ballet, with a cast of thousands, similar to the mass dance scene in the movie "All That Jazz"? Or is it the more pedestrian attempt of thousands of people to go to work, or return home? Even biologists must attempt to understand the phenomenon of stotting deer; do these creatures jump up and down to altruistically warn their colleagues of the presence of wolves, or is this behavior a message to the predators: "See how fit I am? You'll never catch me. Better focus on these other deer." The point is, praxeology works hand in glove with *vershtehen*. Unless there are extenuating or contrived circumstances (e.g., they are filming a movie in Grand Central Station, and all of those "commuters" are really actors; or, what appears to be a contract signing is really a penmanship class), we *know* what a contract signing means. But in the case of supposed envy, we really do not. Yes, sometimes it is real envy. But other times it can well be a joke or a lie, or, perhaps even more likely, a "rent seeking" attempt to divert resources to oneself. Praxeology, combined with *vershtehen*, cannot, as a matter of economic science, take cognizance of envy. But it certainly can interpret contract signings for what they are.

Putting one's signature on a contract is not merely penmanship or writing one's name; it obligates the person to act according to the terms of the contract. Signing one's name on a napkin, i.e., that act of signing, may indicate only what Caplan claims; but signing a contract binds one to other actions besides merely signing. Also the envy of a third party cannot be used to overrule the demonstrated preference of traders making a voluntary exchange. The action that demonstrates his envy increases his welfare since he preferred it. But, scientifically, we can no know nothing about states of mind not demonstrated in action.

Taking a stance as the defender of laissez-faire capitalism vis-à-vis Rothbard, Caplan (1999, pp. 833, 834) taxes the latter for his "agnosticism" on the issue.[22] This charge goes as follows:

> It is important to note, however, that Rothbard does not claim that government intervention reduces social utility. Since the victim loses and the intervener gains from the application of coercion, it would be impossible to assert this without making a *verboten* interpersonal welfare comparison. Rothbard could only claim the welfare

[22]In Rothbard's long career, he has been criticized for most things under the sun, but not usually for insufficient advocacy of economic freedom. This argument was first made by Prychitko (1993).

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> effect of government intervention upon social utility is indeterminate. . . . His welfare criterion justifies agnosticism about—not denial of—the benefits of state action.

In sharp contrast, Caplan (1999, p. 835) and his ilk *are* in a position to take a truly critical view of the state. Relying on Coasian (1960)-Posnerian (1998) neoclassical wealth maximization,[23] "allows one to make efficiency judgments about the real world to judge, for example, that Communism was inefficient, or rent control is inefficient, or piracy was inefficient."

There are problems here.

First of all, it was Mises and his followers, *not* neoclassical empiricists such as Friedman, nor for that matter market socialists of the Lange-Taylor stripe, who could point to the inefficiency of Communism. For the logical positivists, the claim that communism is inefficient must always and ever be a tentative one, dependent upon further evidence. Only the Mises (1966; 1981) critique, in sharp contrast, would get to the essence of the matter and show the underlying fallacy of this system.[24]

Second, there are serious and grave problems with the Coase-Posner approach.[25] For one thing, it commits the same "*verboten* interpersonal welfare comparison" Rothbard has successfully evaded. Rothbard, we have seen, was unable to consider state action necessarily harmful in that it benefited some, and harmed others, and without interpersonal comparisons of utility, he could not conclude that the former outweighed the latter.[26] One gets the impression from Caplan that the neoclassicals were somehow able to overcome this minor obstruction. Nothing could be further from the truth. Instead of overcoming it, they ignore it. For another, Coase and Posner is an attack on the very institution of private-property rights which underlies economic growth and development, in that it asks judges to play essentially the role undertaken by Soviet planners.[27]

Third, it is by no means clear that economists, at least of the Public Choice School variety, are in any position to maintain that Communism, rent control, or piracy are inefficient. Worse, in a *reductio ad absurdum*, Lee (1999) has explicitly

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[23]The Coasean philosophy has been widely adumbrated; this literature includes Coase (1960), Demsetz (1966; 1967), Posner (1992) and Medema (1997; 1998; 1999).

[24]On this see Mises (1966, chap. 26; 1981, chaps. 5 and 6), Rothbard (1976), Salerno (1993), Hoppe (1996), Hülsmann (1997).

[25]Critics of Coase, Demsetz and Posner include Block (1977, 1995, 1996, 1999), Cordato (1989; 1992; 1998), Krecke (1992), North (1992), and Rothbard (1990).

[26]This is why Rothbard (1973; 1982) based his defense of market not mainly on utility, but rather on rights and justice.

[27]When property rights are under dispute, and they always are, at least potentially, they are to be awarded in the positive transactions costs world not to those who have homesteaded or purchased them in the past, but rather to those who in the opinion of the judges can make the best (wealth maximization) use of them in the future. If this is not central planning, one is at a loss to specify precisely what is.

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taken the very opposite tack: that these things and more, far more,[28] are actually *efficient*, given the overriding importance of subsidizing those responsible for the provision of public goods. Rothbard is known far and wide, and justifiably so, as perhaps the single greatest critic of statism. Neoclassical economists such as Friedman, Coase, Posner, Buchanan, Tullock, Demsetz, etc. are, at least compared to him, veritable socialists.[29] For Caplan to conclude that their criticism of governmental intervention is more profound than Rothbard's cannot be justified.

Fourth, far from an attack on Rothbard, Caplan's is actually a high compliment. Rothbard, and to a degree all free-market economists, are continually accused of orienting their technical economics toward political and ideological ends; that is, approaching science with a free-market ax to grind. There is no one who would have more wanted to be able to definitively conclude that government action could be shown to be harmful than Rothbard. The temptation to engage in economically illicit interpersonal comparisons of utility toward this end must have been especially powerful for him. Yet, unlike the neoclassicals, he resisted them. He adopted his "agnostic"[30] position because the logic of economics compelled this conclusion, and forbade what for him would have been a far more welcome one. But, better a valid claim that state action cannot be proven beneficial than an invalid one that it can be proven harmful, especially emanating from a quarter known for its *support* of government intervention, not opposition.[31]

Public Goods

The Austrian position on public goods is stark and clear.[32] There are no positive externalities of which the police and courts should take cognizance, since they cannot be demonstrated, or revealed through human action. (The market, in contrast, can internalize externalities of this sort, if they exist, in common parlance, through privatization and private property, through condominiums, restrictive covenants, discrimination, segregation, etc.) As for external diseconomies, they fall into two categories. First, smoke, noise pollution, crime, trespass and other physical invasions. It is precisely to counteract acts of this sort that we have police and courts in the first place (Rothbard 1990; Block 1998; Whitehead and Block 1998; Yeatts and Block

[28]For example, the military industrial complex, the environmental industrial complex. etc.

[29]See on this Block (1995a, pp. 61–125; 1995b, pp. 15–26, 151–55; 1977, pp. 111–15; 1999, pp. 15–33; 1996, pp. 265–86; 1994, pp. 31–64; 1998c, pp. 315–26); Block and Gordon 1985, pp. 37–54).

[30]Caplan (1999, p. 835) discusses Mises (1966, p. 659) and states: "Thus, while Mises's analysis initially sounds neoclassical, his discussion of positive externalities appears to make the strong claim that the free market *ipso facto* serves the most urgent needs of the consumer." Question: how is it possible to reconcile this claim with the charge of "agnosticism"?

[31]Caplan (1999, p. 833, n. 20) cites the very important work by Salerno (1993, p. 131) who is able to conclude that intervention is unambiguously welfare reducing only by "completely discount[ing] any gains, in terms of direct utility or exchangeable goods, that accrue to the interveners and their beneficiaries."

[32]See on this Rothbard (1990; 1993, pp. 883ff.), Hummel (1990), Block (1983), Hoppe (1989, chap. 10; 1993, chap. 1).

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forthcoming; Whitehead and Block forthcoming; and McGee and Block 1994). Second, are the external pecuniary diseconomies, including all other supposedly negative effects which cannot be demonstrated through human action. For example, I open a grocery right across the street from yours, and "steal" some customers, much to your (not demonstrated, but likely real) consternation. These, too, since they do not constitute uninvited border crossings, are to be ignored by the forces of law and order.

Public goods for the neoclassicals are entirely a different matter. This concept is used, to be accurate about it, as an entering ideological wedge for government intervention into the economy. If there are alleged to be external benefits of schooling, for example, this justifies taxes and subsidies for this industry. Even though the universities typically teach Marxism, feminism, black studies, sociology, multiculturalism, political correctness and other "disciplines" hardly conducive to the good ordering of society (Kors and Silverglate 1998), and even though there exists no unambiguous way to measure the costs and benefits, still, the theory is widely used for this end.

Caplan (1999, p. 836) concedes that:

> Economists, applying public goods theory have all too often failed to consider the possibility that consumers' valuation of the alleged public good is less than its cost of production. But just because some people misuse an economic theory does not invalidate it.

The problem is, how does Caplan or anyone else *know* when the theory is well or ill used? Without any independent criterion of success, there would appear to be a daunting task. Caplan (1999, pp. 835, 836) allows that Rothbard's utility theory would not countenance any such conclusion, but insists that "contra Rothbard, preferences can exist without being acted upon." Sure they can, in the ordinary commonsensical notion. The problem is, however, to *measure* these things in the absence of human action. How does Caplan solve the problem, for example, of whether education, or defense, are or are not appropriate applications of the theory or not? He, as is the wont of the neoclassicals, gives us no answer whatsoever.

CONCLUSION

We have tried to take Caplan to task for his many errors of omission and commission. Nevertheless, we think his was a very worthwhile article. Why? First, its quality. As a critique of Austrianism it far surpasses many of the others cited above, and is easily in the class of Nozick (1977), which we certainly mean as high praise. Second, it is important for the profession as a whole to at least be aware of the praxeological tradition, and the publication of an article critical of it in as prestigious a periodical as the *Southern Economic Journal* cannot but help in this regard.[33] It is no exaggeration to state that the typical member of the economics

[33]There are now three periodicals in regular publication dedicated to the study of Austrian economics. They are *The Quarterly Journal of Austrian Economics*, *The Review of Austrian Economics*,

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profession is far more aware of another heterodox view, Marxism, than he is of Austrianism. And yet, surely even Caplan would agree, the latter has far more to offer the practitioner of economics than the former.

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and *Advances in Austrian Economics*. It is fair to say that even altogether, these three have far less influence within the economics community than does the *Southern Economic Journal*.

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A Pre-History of Misesian Calculation: The Contribution of Adolphe Thiers

Reinhard Stiebler

Hayek (1975, p. 33) states, that Mises's article on "Economic Calculation in a Socialist Community" (1920) and the elaboration of the arguments contained in his book *Socialism* (1922) were "the most complete and successful exposition" of the central economic problem of socialism.

In short Mises's argument says that there must be a free market for factors of production, because without their exchange there would be no possibility to determine their monetary value, and without market prices attached to the factors no rational or effective allocation of them would be possible. While Mises denied the theoretical possibility of rational allocation without market prices, Hayek and Robbins conceded the theoretical possibility and questioned only the possibility of a practical solution.

The ensuing discussion unearthed several forerunners. Steele (1986, p. 73) lists Wieser (1889), Pierson (1975, pp. 41–85), and Barone (1975, pp. 245–90) and points to the earliest, insufficient attempts in refuting socialism either via the incentive problem (going back to Malthus 1798) or the inefficiency in handling the information and finding appropriate solutions in the planning process (Smith 1776).

Mises himself has hinted at Gossen as a forerunner to his argument. In a footnote (p.117) he states: "We may point out here that as early as 1854 Gossen (p. 231) knew

> that only through private property is the measure found for determining the quantity of each commodity which it would be best to produce under given conditions. Therefore, the central authority, proposed by the communists, for the distribution of the various tasks and their reward, would very soon find that it had taken on a job the solution of which far surpasses the abilities of individual men.[1]

Reinhard Stiebler is co-founder of the Liberale Akademie Berlin, a libertarian think-tank to promote the Austrian School in Germany.

[1]This argument–which identifies with the "efficiency problem" which goes back to Adam Smith –is not at all comparable to the powerful argument of Mises. On the contrary it considerably weakens the classical-liberal position, the implication being that, with the development of sheer calculating power embodied in computers one day there would be a chance for socialists to set up the paradigm which they had been looking for.

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In this article we will present an even earlier description of the problem of economic calculation under socialism. It was put forward by the French economist, historian, and politician Adolphe Thiers in his book *De la propriété* (On property, 1848). Because he is virtually unknown today we will give some background before we discuss the content of *On Property*.

ADOLPHE THIERS, HIS LIFE AND WORK UNTIL 1848

Louis-Adolphe Thiers was born on April 16, 1797 in Marseille and was educated at the faculty of law in Aix-en-Provence. He went to Paris in 1821 and soon became a contributor of the *Constitutionnel*. From 1823 to 1827 he published the ten volumes of his celebrated *History of the French Revolution*. Early in 1830 he helped found the *National*, a new opposition newspaper, and took a leading part in the revolution. He was one of the signatories of the protest against the "July Ordinances," by which Charles X dissolved the parliament, abolished the freedom of the press, and reduced the electorate to the about 25,000 landed proprietors. At the end of 1830 he became a Member of Parliament and held a subordinate post in the finance ministry. In the years from1832 to 1836 he repeatedly changed his portfolio, acting as minister or prime minister, resigned in 1836, but in 1840 he was president of the council and foreign minister for the second time, if only for six months. He remained a Member of Parliament under the monarchy as well as during the republic proclaimed in 1848.

Thiers was sometimes said to be a dubious and polarizing character.[2] Having become well known in French classical liberal society in the twenties he ranked as one of the radical supporters of the new dynasty of 1830. Beginning in 1831 he became much less radical and between 1832-1836 he held his offices in an increasingly repressive government. Under the republic he took up the position of conservative republican, but voted for Prince Louis Napoléon as president. He was one of the main adversaries of Proudhon in parliament, where he opposed him on the "right to work," which had been proclaimed in February 1848, and on his project of a "Banque d'Échange," which planned to issue paper money backed only by the "national product."

Thiers has been almost completely ignored by later economists. He appears in the contemporary *Dictionnaire d'Économie politique* (Coquelin and Guillaumin 1852, p. 733f.), yet he does not appear in Rothbard's *Classical Economics*. Schumpeter, in his *History of Economic Analysis* (1954, p. 426), refers to Thiers only as the author of the *History of the French Revolution* and classifies him among the "writers whom we do not value primarily as scholars, for example, Thiers, the politician." We take this reference to him as being a (more or less opportunistic) politician as the main reason why later scholars did not refer to him.[3]

[2]See e.g., his characterization in the *Encyclopaedia Britannica* (1963, p. 133).

[3]Only after we had finished this article did we learn about *The Lost Literature of Socialism* by George Watson (Brownlow 1999, pp. 27-29), the contents of which are here therefore not taken into account.

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THIERS'S *ON PROPERTY*: THE ORDER OF THE ARGUMENT

After the breakdown of the "social republic" (February–June 1848), Thiers wrote his book *On Property*, which was finished in September 1848 and published at the end of that year. His argument was based on what he considered to be obvious for a classical liberal at that time:

> There was a simple evidence regarding certain moral truths, which we thought to be axioms without need for demonstration because of their inherent clarity: A man works and collects the price of his work; as price he receives money, he exchanges the money for bread or clothing and thus consumes it; if he has too much of it he lends it and he is paid interest, of which he lives; or else he gives it to whoever he pleases, his wife, his children, his friends. (Thiers 1848, p. 2)[4]

> I try to be clear, brief, and conclusive while proving to my contemporaries, what they believed never needed any proof, namely that what they have earned yesterday is theirs, just theirs and they can either support themselves or their children with it. See where we are today, where false philosophers have brought us, who band together with a mob led astray. (Ibid., p. 5)[5]

In chapters 2 thru 5 of the first volume (there are four) he proceeds to give a foundation of property. In fact he gives three separate derivations of the right to property, giving the reader the less convincing arguments first and then proceeding to the irrefutable.

In chapter 2, Thiers proposes to deduce natural laws from the observation of human nature in the same way as of things and animals, concluding that because man is a moral being "the laws constitute the rights" (p. 19) for him. Yet this introduces human needs on the rightfulness or wrongfulness of which Thiers cannot decide. Therefore he has to give the *utility* of property for society a place in his reasoning.

In chapter 3, he makes the *historical and ethnological* argument, that property is a universal constant of all times and all people (p. 20).

In chapter 4 and 5, he derives property from man's perception of his existence: To exist as a human being means to own oneself. Therefore a man can claim the ownership of himself, his ego, his mental faculties. From this derives the person's ownership of his body. These two forms of property Thiers calls the "first property." A "second property," which is one's work and the product of this work, then arises from the first. Here Thiers stresses the incentive argument, namely that without the attribution of ownership of his own labor's product man would refrain from producing at all, taking only what is directly at hand to satisfy his immediate needs.

The second part of *On Property* deals with communism as the absolute and unconditional negation of property, the doctrine, that man works not for himself, but for society. Thiers undertakes to show the logical impossibility of communism.

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[4]The translation is ours.

[5]Again, the translation is ours.

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> I have given a direct proof, I have shown, that society is based on the simple, fertile, necessary principle of individual property; now I will give the indirect proof and show society as if being based on the opposite principle (if it is possible to imagine something like that for a moment), on the negation of property and on the community of goods, thereby using the *proof by the absurd* like the mathematicians do. (p. 131; italics are mine)

Here, Thiers takes up again the incentive argument. If under communism every worker is paid the same amount for his work (and this is a prerequisite otherwise differences in wealth would instantly reappear), workers will reduce their work effort or will have to be supervised continually and oppressively (p. 134). On the consumption side people have no incentive to, and in fact can not be allowed to, save.

THE ECONOMIC CALCULATION ARGUMENT

The third part then is devoted to socialism. Socialists, according to Thiers, are those people who do not want to abolish property completely, but want to correct, by different means, the effects of private property. Here Thiers concentrates on three particular features or models of socialism[6] current in the discussion of that time: Cooperatives, mutualism,[7] and the right to work.[8]

It is in the discussion of the working of cooperatives, that Thiers introduces the economic calculation argument. The cooperatives had been proposed by Louis Blanc in his *Organization of Work* (1839) and had been set up in 1848 during the months of the "social republic" with shattering results.[9]

The proposed solution to the perceived inequalities between workers and enterprise owners had been:

1. To fix output prices and quantities to eliminate competition, whereby the one who used capital, work processes, and inventions more efficiently could undercut the prevailing market price thus causing other companies who did not adapt to be forced out of the market (p. 181f.).

2. To transfer the ownership of the new industrial companies to workers' associations with the necessary capital being supplied by the government (or guarantee).

Having discussed questions of capital and management related to the creation of cooperatives, Thiers adds a chapter "On the Suppression of Competition" (chap. 7), discussing the role of a free market for the formation of prices, from which the following quotation is taken:

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[6]Thiers's concept of "socialism" compares with Mises's "interventionism," which equals today's social democracy.

[7]The system proposed by P.-J. Proudhon with the Exchange Bank ("Banque d'échange") at its core.

[8]Which in fact was on the agenda of all socialists like Louis Blanc, Pierre-Joseph Proudhon, Victor Considérant, Pierre Leroux, or Étienne Cabet.

[9]Later their defenders claimed that Blanc's ideas had not truly been realized by them.

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> What is it, what has been complained about in fact? That everybody, if he is left to himself, undercuts prices by an unrestrained competition. Is it about this, yes or no? What remedy can be found against that? Should one leave everybody to produce as much as he wants, as in the past? But then everything would be exactly as it was before. . . . If one really strives to stop the evil it would be necessary that the cooperatives, cooperating with one another, come to a mutual understanding, by means of a general government, to limit production. Then one would really have achieved something. *But which basis would one use to support the claim: There is enough of cotton fabric, enough cloth, enough iron? There is only one, the price,* because it is impossible in a society of 20, 30, 40, or 80 million people to know, whether there is enough of food, clothing, or housing, or not. There is only one method to judge about this by that which is called the exaggeration or decrease of prices. The only element of decision to limit production would evidently be the price. *You would have therefore decided this insignificant question, this question of such little importance, which is called the price of things, by your own opinion*! Yes, that is the certain, infallible consequence of the system of cooperatives: Either you have nothing done, absolutely nothing, but to suppose a reserve which even today's entrepreneurs are not able to procure from their profits, or you would have engaged in a contract to fix the price of all products; and *what is in fact which fixes the price in a free society. Competition. Suppress it, and you have to fix it yourself.*
>
> This then is the society which you would like to constitute: one immense privilege, in the middle of the republic, after the fall of several monarchies, which have been dethroned for the crime of privilege, the privilege of election, the privilege of publication, the privilege of taxes. This would be the last word of the new brotherhood! (Pp. 256–58)[10]

Thiers does not distinguish between the abolition of the markets for the factors of production and the monopolization of the production of consumer goods. He remarks that with the total or even partial suppression of competition by mutual price fixing between monopolistic cooperatives there can be no free-market price resulting from that competition. In consequence there would be no possibility to determine the right quantities to be produced of any consumers' goods. Price fixing becomes arbitrary, depending on subjective opinion rather than rational calculation by the owners or managers of the monopolistic cooperative or the government, which protects it. We take Thiers's hint of the role of prices in the presence of millions of people not as a reference to the complexity of the calculation as in the case of Gossen, but to the inability of asking directly for the valuations of the consumers.

THE IDEOLOGICAL ENVIRONMENT LEADING TO THIERS'S WORK

Compared to literature from other countries the stress on property is unique. What were the intellectual foundations and what were the circumstances that led to this work?

[10]My translation and emphasis added.

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1. It was probably the Catholic background incorporating the Scholastic speculations which favored this focus. One of the Scholastic traditions was the teaching about the existence of a natural law governing human action and the discussions about the character of the "just price" (*pretium iustum*). Catholicism had always been very strong in France. Thus the French Physiocratic School (physiocracy being the philosophy of the "natural state") could draw on this Catholic legacy, which held that it is the free exchange that generates the just price.

A different case was Great Britain, where the largely empiricist attitude of scientists and philosophers would have hindered a comparable work. The British tradition tended to favor utilitarian thinking, which was taken up later by the Lausanne School.

In this respect one could state that the Austrian School was a continuation of that older stream of thinking of which Adolphe Thiers was a part.

2. As it becomes clear from Thiers's introduction to his book, it was the conflicts with socialists at the beginning of the nineteenth century, who were strongest in France, which led to the necessity to state clearly the principles from those traditions. Even granting the socialists, that their main interest was the question of what constitutes equity and justice in society, the French Revolution elaborated not only on the principle of justice but also on that of democracy, that is the legitimiziation of the tyranny of the majority. The increasing role of socialist ideas in Germany supported by left Hegelianism led to the same necessity to restate the principles of human conduct, on which society was founded, of which Gossen's work is a part.

Conclusion

Mises's argument on the impossibility of economic calculation under socialism, first proposed in 1920, has forerunners. One of the early forerunners was Adolphe Thiers in his book *De la propiété*, which was published in 1848.

Thiers understood that he was fighting for the case of the economists against socialists and communists. He wrote a popular book after the socialist revolution of 1848 putting forward an eloquent defense of property as the foundation of society.

Although largely neglected, his work is interesting because he based economic argument on a property-rights framework and because he already hinted towards the problem of economic calculation under socialism.

The particular force of his argument lies in the refutation of economic calculation under socialism not only on grounds of practicability, but of a theoretical reasoning about the role of property and thus the role of the market and prices for the allocation of goods.

Being himself a politician he was compromising in the application of his own principles, which makes especially the last part of his book, *On Taxation*, contradictory in view of the preceding parts.

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Thiers's argument can be interpreted as resulting from the tradition of the natural-law school of the Physiocrats, who could themselves draw on the Catholic tradition of natural law and the discussion of the "just price."

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KNOWLEDGE, CALCULATION, CONFLICT, AND LAW

N. STEPHAN KINSELLA

THE STRUCTURE OF LIBERTY: JUSTICE AND THE RULE OF LAW. BY RANDY E. BARNETT. NEW YORK: OXFORD UNIVERSITY (CLARENDON) PRESS, 1998.

PERVASIVE SOCIAL PROBLEMS

Libertarian theorists have made significant contributions to the fields of economics, politics, and even philosophy. Intimately bound up with libertarian and political theory, of course, is the question of what laws and legal systems are appropriate. Law and legal theory, therefore, have also been subjected to libertarian scrutiny. The writing in this area, however, is usually focused on narrow legal topics, such as contract or constitutional law (Evers 1977, pp. 3–13; Barnett 1986a, p. 269; 1995, p. 93; 1993, p. 853; Spooner 1992; and McGee 1992, pp. 451–76). Moreover, many libertarian authors are economists or philosophers who are not sufficiently familiar with the workings of real legal systems; others are not completely or consistently libertarian in their approaches.[1] Jurisprudence has yet to receive the attention it deserves from libertarians.

The publication of Randy Barnett's latest book, *The Structure of Liberty: Justice and The Rule of Law*, helps to fill this lacuna. Barnett, as a former criminal prosecutor and now law professor at Boston University School of Law, is intimately familiar with the operation of the American legal system and also with the arcana of academic jurisprudence. His libertarian credentials are also impeccable: he has published important libertarian-oriented works on topics as diverse as contract

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[1]Various works with at least a semi-libertarian approach to legal and consitutional theory include DeRosa (1996), Berger (1989), Bork (1990), Quirk and Bridwell (1995), Leoni (1991), Hayek (1973; 1976; 1979), Epstein (1985; 1995; 1989). Richard Epstein has contributed enormously to libertarian and legal theory, but is not a completely consistent libertarian and is certainly not an anarcho-capitalist. Moreover, Epstein adheres more to mainstream, neoclassical economics in which interpersonal utility is both relevant and comparable (see, e.g., 1995, p. 141), than to Austrian economics, which does not suffer the many theoretical deficiencies of neoclassical economics, e.g., interpersonal utility comparisons, logical positivism and scientism, etc.

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law, constitutional theory and natural rights, restitution and criminal law, and drug prohibition.[2] Barnett was thus well-positioned to write *The Structure of Liberty*, the first broad and systematic treatise on legal theory written from a thoroughly libertarian perspective.

Barnett's aim in this ambitious book is to determine the type of legal system, laws, and rights which are appropriate, *given* the widely-shared "goal of enabling persons to survive and pursue happiness, peace, and prosperity while living in society with others" (p. 23). Happiness, peace, and prosperity are fine principles to select and quite compatible with libertarianism, but Barnett does not attempt to try to justify these basic norms or values. His argument is thus hypothetical and consequentialist, though not, he maintains, utilitarian (pp. 8, 12, 17–23, esp. 22–23).

According to Barnett, the goals of social happiness, peace, and prosperity cannot be achieved unless society's politico-legal system somehow solves certain *problems* which stand in the way of this happy state. These are "the serious and pervasive social problems of knowledge, interest, and power" (p. 3, emphasis added). Libertarianism enters the picture because the libertarian (Barnett prefers the inferior and confusing term "liberal") conceptions of *justice* and the *rule of law* provide the "structure of liberty" that addresses these problems. These principles include the "natural background rights to acquire, possess, use, and dispose of scarce resources (and other rights as well)" (p. 16). Barnett's argument thus proceeds by showing how and why libertarianism is the best way to overcome the problems of knowledge, interest, and power.[3]

THE FIRST-ORDER PROBLEM OF KNOWLEDGE

Parts 1, 2, and 3 of the book respectively describe the three fundamental problems, and how they are solved by libertarian rights and institutions. Barnett's first topic, discussed in Part 1, is the problem of knowledge, which is broken down into separate first-order, second-order, and third-order aspects.

The first aspect—basically the Hayekian "knowledge problem" (Hayek 1948b,c)—concerns how individuals make "knowledgeable" use of physical resources (p. 29). This analysis starts out by presuming that an individual needs to "be able to act on the basis of [his] own personal knowledge," and "when so acting [he] must somehow *take into account* the knowledge of others" (p. 36; emphasis added).

Alas, this is difficult to achieve, because such knowledge is "dispersed" or "fragmented," and each individual has "ever-changing and potentially conflicting personal and local knowledge of potential resource use" (p. 40). Each person is thus rendered "hopelessly ignorant" of the "knowledge of others." So the alleged

[2]See, e.g., Barnett (1996, p. 157; 1986a; 1993; 1995; 1997, pp. 745–93) and others cited in the Bibliography to *The Structure of Liberty*.

[3]*The Structure of Liberty* contains excellent summaries provided throughout the book at the end of many chapters and sections. Excerpts from the book may also be found on the web at http://www.bu.edu/rbarnett/SOL.htm.

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problem is this: given the dispersed, often inaccessible, and potentially "conflicting" nature of such knowledge, how can individuals act on the basis of their own knowledge, while avoiding conflicts over resource use? And how can they take into account the knowledge of others (p. 36)?

According to Barnett, libertarian rights are necessary because they facilitate the sharing and dissemination of knowledge (p. 44). They include the natural rights of "several" property (Hayek's term for private property), Lockean first possession (homesteading), and freedom of contract (p. 83). If individuals are accorded these rights, the first-order problem of knowledge is solved. One of the main ways this happens is that prices arise under such a private-property order, and prices themselves convey, in "condensed" form, personal and local knowledge.

Knowledge vs. Calculation

There is, unfortunately, much to be desired in Hayek's emphasis on the role of knowledge in the economy, as opposed to Ludwig von Mises's stress on the more fundamental role of money prices in *economic calculation*.[4] Hayek's and Mises's differing views have been improperly conflated (Salerno 1993), and Barnett makes the same error by attributing to Mises Hayek's views on the information-conveying role of prices (p. 54, n. 21).

What, then, are the differences between Mises and Hayek on the role of prices in the economy? Hans-Hermann Hoppe has ably summarized Mises's original calculation argument as follows:

> If there is no private property in land and other production factors, then there can also be no market prices for them. Hence, economic calculation, i.e., the comparison, in light of current prices, of anticipated revenue, and expected cost expressed in terms of a common medium of exchange—money—(thus permitting *cardinal* accounting operations), is literally impossible. Therefore, socialism's fatal error is the absence of private property in land and production factors, and, by implication, the absence of economic calculation. (Hoppe 1996, p. 143)

The theories of Hayek on which Barnett and others have relied, however, downplay calculation and appraisement in favor of communication of knowledge. For Hayek, as Jörg Guido Hülsmann notes,

> the impossibility of socialism stems from its inability to *communicate dispersed knowledge*. . . . [I]nformation about the particular circumstances of time and place can never be centralized. It necessarily exists in dispersed form and yet it can be communicated by the market prices of capitalist societies. Only capitalism is thus capable of solving the knowledge problem. (Hülsmann 1997, p. 23; emphasis added)

[4]This has been pointed out in recent debates among Austrian economists, published primarily in the pages of *The Review of Austrian Economics*. See Hülsmann (1997, pp. 23–48), Hoppe (1994, pp. 67–93; 1996, pp. 143–49), also Salerno (1990, pp. 25–54; 1993, pp. 113–46; 1994, pp. 111–25; Herbener (1991, pp. 33–50). For recent, related papers less critical of Hayek's position, see Horwitz (1998, pp. 427–50) and Caldwell (1997, pp. 1856–90).

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But any informational function of prices is, at best, only secondary in comparison to the primary role of private property and money prices. The fundamental economic role of private property, along with money prices arising from exchanges of such property, as Mises showed, is to permit *economic calculation*. And, socially speaking, private-property rights serve to prevent conflict over resources. *This* is why private-property rights serve Barnett's goals of peace and prosperity: private property rights permit conflicts to be avoided (peace) and allow genuine, free-market money prices to form which can be used for economic calculation and hence rational resource allocation (prosperity).

Concentration on the information-conveying role of prices instead of calculation obscures this role.[5] For example, Hayekians claim that prices contain economic information in "condensed" (or encrypted, encoded, or abridged) form.[6] Barnett follows the Hayekians when he states that "the knowledge-disseminating function of prices is largely unknown . . . the knowledge embedded in prices is not explicit. . . . It is encoded knowledge" (p. 54).

There are several problems with viewing prices as encoding information. For one thing, concepts such as encoding, encryption, and the like imply an encoder—a person who actively and consciously *encodes* information in some communication medium, in accordance with some encoding scheme (i.e., the code). Yet there is clearly no intentional encoding of whatever knowledge may be embedded in prices; there is no encoding scheme and no way to decode the information. I buy a car for $30,000 because I think it is worth it, not to convey some secret message to someone.[7] Knowledge that I paid this price for the car

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[5]Leoni (1991, p. 89 *passim*), seems to similarly attribute Hayekian knowledge-related concepts to Mises:

> [T]hat the central authorities in a totalitarian economy lack any knowledge of market prices in making their economic plans is only a corollary of the fact that central authorities always lack a sufficient knowledge of the infinite number of elements and factors that contribute to the social intercourse of individuals at any time and at any level.

See also Kinsella (1995, pp. 132–181, esp. 157–60), in which I, too, influenced by Leoni, conflated Hayekian and Misesian ideas in overstating the analogies between central economic planning and central law-creation. See note 25, below, and accompanying text, concerning the possibility of deducing more concrete legal principles from (themselves deduced) abstract rights.

[6]The term "data compression" is often used synonymously by engineers with terms such as data encoding or encryption, so I suppose it is only a matter of time before Hayekians say that prices convey, in "compressed" form, fragmented and dispersed local knowledge of the particular circumstances of time and place.

[7]The encoding metaphor seems to be a pseudoscientific and scientistic attempt to give this kind of economic theorizing a patina of scientific respectability by borrowing engineering terminology. It is scientistic because, in vainly trying to borrow natural science terminology, there is an assumption that only the "hard" or natural sciences have true validity. It is akin to using such inapt phrases as the "momentum" of the leading team in a basketball game, the "energy" of crystals and astral forms, or, even worse, "revving the engine" of the economy. Both economics and ethics can be sciences, but not in the same way as the causal, natural sciences. On scientism

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does not reveal any information about the underlying objective conditions that give rise to this price (e.g., the intensity of my demand or the relative scarcity of the car). Such knowledge reveals only that I valued the car more than $30,000, and the seller had the opposite valuation.

Prices result from the subjective evaluations of goods by seller and buyer, but prices *are* exchange ratios. Beside these ratios, what other information *could* money prices communicate? What information can a mere price ratio convey? Take Hayek's famous tin example, which assumes

> that somewhere in the world a new opportunity for the use of some raw material, say, tin, has arisen, or that one of the sources of supply of tin has been eliminated. *It does not matter* for our purpose—and it is significant that it does not matter—*which* of these two causes has made tin more scarce. All that the users of tin need to know is that some of the tin they used to consume is now more profitably employed elsewhere and that, in consequence, they must economize tin. There is no need for the great majority of them even to know where the more urgent need has arisen, or in favor of what other needs they ought to husband the supply. If only some of them know directly of the new demand, and switch resources over to it, and if the people who are aware of the new gap thus created in turn fill it from still other sources, the effect will rapidly spread throughout the whole economic system and influence not only all the uses of tin but also those of its substitutes and the substitutes of these substitutes, the supply of all the things made of tin, and their substitutes, and so on; and all this without the great majority of those instrumental in bringing about these substitutions *knowing anything at all about the original cause of these changes.* (Hayek 1948c, p. 85; emphasis added)

In this example, what information, *exactly*, is supposed to be conveyed by prices? Let us explore the possibilities. Can the original *cause* of the price increase (i.e., the change in demand or supply) itself be conveyed via prices? Well, no. Prices are the *result* of action. Thus, action that changes the prices must already be informed by knowledge.[8] Entrepreneurs *first* see the changed conditions and *then* bid prices up or down. They do not learn about the changed conditions *from* the resulting prices. Rather, they *cause* the prices to change, based on their appraisement of tin and knowledge or judgment of underlying conditions. Hayek seems to recognize that those entrepreneurs who "know directly of the new demand, and switch resources over to it" do not learn from prices, but rather help to form prices *based* on their own preferences, knowledge, evaluations, and judgments.

What about users of tin who merely observe the change in prices paid for tin—do these persons learn anything, from observed past prices, about the

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and empiricism, see Rothbard (1997b) and Hoppe (1989a, p. 179). On epistemological dualism, see Mises (1962; 1981) and Hoppe (1995; 1989a).

[8]In other words, the prices generated on the market are *past* prices, which are always the *outcome* of action, *not* its cause. Hülsmann (1997, p. 26) explains that "all information that this action was based upon had to be acquired beforehand. The price itself could not have communicated the knowledge that brought it [the price] about." With regard to the tin example, "tin does not become scarcer and *then* this fact can come to be known to someone and lead to adaptations. Rather it is the other way around. The very fact that demand increases means that someone *already knows* of a more value-productive employment of tin" (p. 28).

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underlying conditions or "original cause" of the change in prices? No, because any of a variety of causes results in higher or lower prices (e.g., changes in demand by buyers or sellers, decrease in supply, changes in demand for money on the part of sellers or buyers, etc.). For these reasons, Hayek says that mere users of tin do not know "anything at all about the original cause of these changes."

Then what possible information can prices convey? Hayek writes: "[a]ll that the users of tin *need to know* is that some of the tin they used to consume is now more profitably employed elsewhere and that, in consequence, they must economize tin" (1948c, p. 85; emphasis added). But the users do not *need* to know this; if tin is scarcer, there is less of it to go around.[9] Whether the prospective users know of the increased scarcity or not, they cannot use what does not exist. Their plans will have to conform, sooner or later, to this increased unavailability of tin.

At most, one could argue that the existence of prices enables prospective users to recognize the good's relative scarcity somewhat earlier than they would in the absence of prices (that is, sooner rather than later). And even this cannot be stated to be true as an economic law, simply because *all* prices are *speculative*, and based on entrepreneurial judgments and anticipations about future conditions. An entrepreneur, for example, may bid the price of a good up based on a *mistaken* judgment about relevant future conditions, such as supply and demand. What do prices then convey in such a case—misinformation?

In any event, even granting that observers can learn of relative scarcity of a good from prices, emphasis on this aspect of prices distracts from the crucial role that prices play in economic calculation. That is, even if prices do tend to help users to become aware of a good's relative scarcity somewhat earlier than they would otherwise, it is not this function of prices which addresses the insurmountable problems of production and human action that are faced in the absence of private property. The fundamental problem faced by acting man is not the fact that information is dispersed.[10] Rather, it is deciding how to rationally allocate resources in the face of an uncertain future and given the subjective nature of value, which makes it impossible to compare alternative projects or plans in the absence of a cardinal set of prices.

Thus, as Rothbard (1991, p. 66) explains, "what acting man is interested in, in committing resources into production and sale, is *future* prices."[11] The primary role

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[9]Notes Hülsmann (1997, p. 28):

> [a]n increased scarcity of tin implies that some market participants who otherwise could have benefited from tin are now of necessity prevented from using it. If a quantity of tin is sold, then the seller cannot sell it again, *regardless of the exchange rate*. There is simply no more of this tin left.

[10]In fact, as Salerno points out (1994, pp. 114–15), "dispersed knowledge is not a bane but a boon to the human race; without it, there would be no scope for the intellectual division of labor, and social cooperation under division of labor would consequently, prove impossible."

[11]As Mises (1966, p. 332) notes: "Appraisement is the anticipation of an expected fact. It aims at establishing what prices *will be paid* on the market for a particular commodity or what

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of prices in a productive, advanced economy is not to communicate information, but to serve as the *starting point* for estimating what *future* prices will be.[12] The forecasted future prices are then used to quantitatively compare various projects and to select the most profitable—and thus most value-productive—use of resources under consideration.[13] Prices are thus important because they serve as an *accessory of appraisement*. "Current" (immediate past) prices tell only what the current price structure is, and thus serve as a basis for forecasting what the future array of prices will be, given the current starting point. Thus, present prices "can have no communicative function because they are only the, if indispensable, starting point for our understanding of the future."[14]

The problem faced in a society without libertarian property rules is that there can be no money prices and there can thus be no economic calculation. Talk of a knowledge-disseminating role for prices is flawed and misses the point. Accordingly, Hoppe (1996, p. 146) concludes that "Hayek's contribution to the socialism debate must be thrown out as false, confusing, and irrelevant."[15]

Barnett on Knowledge

Barnett's attempt to make knowledge the central inquiry, instead of calculation, scarcity, and interpersonal conflict leads, not surprisingly, to confusion. Barnett maintains that the problem to be solved is "potentially conflicting personal and local knowledge of potential resource use" (p. 40) or conflicting "preferences"

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amount of money will be required for the purchase of a definite commodity" (emphasis added). "The essential elements of economic calculation are speculative anticipations of future conditions," and the entrepreneur calculates based on "an understanding of future conditions, necessarily always colored by the entrepreneur's opinion about the future state of the market" (p. 349).

[12]See Hülsmann (1997, p. 44) discussing the secondary importance of any possible information communicated through prices.

[13]Barnett gives an example of a consumer using prices to decide whether or not to purchase an airline ticket to fly to France (p. 55). But this example ignores the role of prices in entrepreneurial appraisal in favor of its economically less essential role in consumer choices. See Mises (1990, pp. 4–6, 24); Rothbard (1991, pp. 56–57): "consumers goods are not the real problem.... The real problem . . . is in all the intermediate markets for land and capital"; (pp. 58–60): "the crucial decisions in the capitalist economy are the allocation of capital to firms and industries." See also Mises (1966, p. 328): "The driving force of the market process is provided neither by the consumers nor by the owners of the means of production . . . but by the promoting and speculating entrepreneurs"; also pp. 229 and 696. Further see Salerno (1990, pp. 45–46).

[14]Hülsmann (1997, p. 47). Horwitz (1998, p. 441) also notes that current "prices . . . do serve as the starting point for the next round of entrepreneurial appraisement," but then adds, "*because they do provide (imperfect) information about scarcity, wants, and opportunity costs.*" The latter part of the sentence seems to be superfluous and not logically connected to the first. Current prices are the starting point in appraisement because today's prices will change in various ways to result in future prices, which are of interest to entrepreneurs. For a discussion of the connection of current prices to previous prices, see Mises's regression theorem (1966, pp. 408–10; 1951, pp. 408ff.) and Rothbard (1962, pp. 231–37).

[15]See also Rothbard (1991, p. 66; "the entire Hayekian emphasis on 'knowledge' is misplaced and misconceived"), Hülsmann (1997, p. 39; discussing "the irrelevance of knowledge problems"), and Salerno (1990, p. 44: "[t]he price system is not—and praxeologically cannot be—a mechanism for economizing and communicating the knowledge relevant to production plans. The realized prices of history are an accessory of appraisement").

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(p. 38).[16] He then claims that private property and related liberal rules would minimize such conflicts, because it would lead to *you* taking into account *my* information and vice-versa, and to a general spreading of information (in encoded form).

As an example, Barnett hypothesizes that "there is a particular tree between my neighbor's house and mine" (p. 38). One neighbor wants to keep the tree; yet the other wants to cut it down because it blocks his view of the sunset. Although Barnett acknowledges that it is these proposed *actions* (keeping the tree; cutting it down) which conflict with each other, he awkwardly and unnecessarily tries to fit this within the knowledge framework. He writes:

> In my example, my neighbor and I both have personal knowledge of how the tree affects the view from our respective windows. My neighbor and I have personal knowledge of each of our preferences concerning the use of this particular tree. Finally, and most significantly, these preferences conflict or, more precisely, each of us subjectively prefers to use the tree in physically incompatible ways. . . . Notice that there is no *problem* of scarcity in the absence of an incompatibility of subjective preferences. (p. 38)

Now assigning property rights to the tree, as Barnett advocates, does solve the problem of conflict over use of the tree: whichever neighbor owns the tree gets to decide whether to cut it down or not. But this solution has nothing to do with knowledge—except to the extent that non-owners must of course *know* someone else *owns* the tree in order to avoid conflicts over use of the tree.[17] The true way to avoid conflict is to establish, and promote respect for, property rights, not to disseminate "local" knowledge or information about others' preferences.

Barnett's account implicitly recognizes this. He says, for example, that the "radical dispersion of knowledge . . . leads to a knowledge problem when people seek to act on the basis of their differing knowledge in incompatible ways" (p. 41). Note that the phrase "on the basis of their differing knowledge" is completely superfluous here; if it is eliminated, then this says that a problem arises "when people seek to act—*in incompatible ways*"—that is, when there are conflicting *actions* in the *use* of scarce resources. But conflicts are not caused by lack of knowledge, and thus cannot be solved by the spreading of knowledge. Conflicts arise because of the fundamental fact of scarcity and the lack of property rights allocating control of resources to specified owners.[18] That is why property rights are the only way to prevent conflicts over scarce resources.

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[16]One wonders why Barnett does not refer instead to "problems of preference." But this may have been a more obviously faulty notion, as it does not garner automatic respectability due to association with Hayek and other intellectuals.

[17]*See note 23, below, and accompanying text, discussing the boundary-defining role of* property rights and its relation to Barnett's second-order problem of knowledge.

[18]Hayek's model leads Barnett into further error, as can be seen in his statement that "there is no *problem* of scarcity in the absence of an incompatibility of subjective preferences" (p. 38). But this gets it backwards. We cannot even meaningfully say that preferences "conflict" *unless* they are manifested in conflicting *actions* regarding the use of particular scarce resources. Thus the concepts of scarcity and conflict are more fundamental than the notion of

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Why would anyone think knowledge *could* prevent conflict? Even omniscient actors, who are fully aware of each other's preferences and intentions, may struggle for control of a given scarce resource. If lack of knowledge is the reason for conflict over the tree in Barnett's tree example, surely the two neighbors would be able to learn of each other's conflicting preferences—by speaking with or watching each other—more easily than they learn similar facts in "condensed" form from the general price system! How will prices tell owners who *owns* the tree, i.e., who may control it? In fact, the existence of prices *presupposes* a system of private property, which itself *already* resolves conflicts over the use of scarce resources. As Hoppe (1996, p. 145) puts it, "[p]rivate property is the necessary condition—*die Bedingung der Möglichkeit*—of the knowledge communicated through prices." In any private-property system, whether or not prices have yet arisen, the private-property rules themselves suffice to promote peace and cooperation.

And a deeper difficulty looms in Barnett's account. For how can knowledge, or even preferences, of two individuals "conflict"? If we use the term "preference" in the precisely defined meaning it has in praxeology, where it concerns only one's demonstrably preferred use of one's own property (Rothbard 1997c), there *can be* no conflict in preferences. The non-owner simply cannot have demonstrated preferences with regard to his neighbor's property, because these preferences would have to be demonstrated in action with another's property, which is prohibited. And if, instead, Barnett means only to use "preferences" in some colloquial, imprecise sense, how can information prevent conflicting preferences? In this loose sense of preference, individuals can have different preferences, even if they are "aware" of the other's wants. And such a casual conception of preference cannot hope to be used to establish a rigorous case for private property, anyway.

Libertarians (and Misesian-Austrians) recognize that it is only *actions* that can conflict; it is the very possibility of conflict over the use of things that renders these things *scarce* resources and thus possible economic goods. Again, when the rubber hits the road, Barnett recognizes this truth: he notes that "there would be no knowledge *problem* with respect to resource use in the absence of scarcity" (p. 37). He also notes that

> [t]he *actions* of some, not their preferences, are what interfere with the ability of others to pursue happiness by acting on the basis of their own personal and local knowledge. What is sought is a social order in which such knowledgeable actions by everyone are possible. (p. 43).[19]

conflicting preferences or knowledge. On the theory of demonstrated preference, see Rothbard (1997c) and Mises (1966).

[19]Barnett's (p. 77) conception of rights is also consistent with this emphasis on scarcity and action. "[R]ights are construed as enforceable claims to acquire, use, and transfer resources in the world—claims to control one's person and external resources." Such rights are thus *operational* and can serve to guide action so that conflicts are avoided. See also pp. 100–01.

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Thus, when he actually has to formulate operational rules for guiding conduct, Barnett appropriately focuses on conflicting *actions* directed at scarce resources and shows that property rights are necessary to prevent such conflicts. Talk about knowledge and preference conflicts, and about the need for "knowledgeable actions" (instead of successful action), is superfluous and distracting window dressing.

Instead of the misplaced emphasis on knowledge, Barnett could have more straightforwardly noted that there indeed is a problematic potential for interpersonal conflict over scarce resources (including one's body), which would interfere with his assumed goals of peace and happiness. He could then have argued that private-property rights and the libertarian principles of self-ownership and Lockean homesteading solve this problem of interpersonal conflict (Hoppe 1989b, p. 131). Libertarian homesteading and property rules give rise to peace and prosperity, because in such a system conflicts can be avoided and prices can arise to allow economic calculation and thus rational resource allocation.

In fact, this more direct approach could have led Barnett to recognize that it is possible to give much more than a merely hypothetical or consequentialist defense of libertarian principles, by using Hoppe's pathbreaking argument that advocacy of any social ethic other than private property *contradicts* peace- and happiness-conducive norms such as cooperation and conflict-avoidance, which are necessarily presupposed by all participants in argumentation.[20] In fact, in other writings Barnett argues, in a way compatible in approach with Hoppe's argumentation ethics, that those who claim that the U.S. Constitution justifies certain government regulation of individuals are themselves introducing normative claims into discourse, and thus cannot object, on positivist or *wertfrei* grounds, to a moral or normative criticism of their position (Barnett 1995, p. 100).[21]

What about the goal of prosperity? Here Barnett could have pointed out, following Mises, that the private-property order and its accompanying price system also permits economic calculation and thus is the only way to achieve this goal. "Knowledge" would have been recognized as merely a technical problem[22]

[20]See Hoppe (1989b, p. 131). Hoppe's discourse ethics would appear to be a natural complement to Barnett's own views and previous writings, especially given that Barnett has in the past been heavily influenced by Hoppe's mentor Rothbard (1988, pp. 44–45), who claimed that Hoppe "has managed to establish the case for anarcho-capitalist-Lockean rights in an unprecedentedly hard-core manner, one that makes my own natural law/natural rights position seem almost wimpy in comparison."

[21]See also Barnett (1995, pp. 93–122; 1993, pp. 853–68; 1998, p. 122) following Fuller in arguing that the common law usefully requires parties to state their claims in terms of rights, thus necessarily asserting (presupposing) some principle or standard by which the claim to right can be tested.

[22]Hülsmann (1997, p. 44). The need to acquire knowledge faces even Crusoe alone on his island, who has no need for private-property rules because there are no other people and thus no possibility of interpersonal conflict.

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that confronts any individual when choosing means to achieve certain ends, and when deciding which ends to pursue.

As for the right to contract (contractually transfer resources to others), Barnett provides a Byzantine argument that such a contract-based system is desirable because it requires the buyer to take the current owner's knowledge "into account" (pp. 53–54). Barnett also favors freedom of contract because it allows a price system to emerge, which serves as a powerful engine for the encoding and transmission of knowledge. Again, knowledge need not be even mentioned to support the institution of contracting. First, Barnett has already argued that the rights to homestead and use property are necessary to solve conflicts and promote prosperity. But the right to contract is implicit in the rights to acquire and use property. This is because if one has the right to acquire property, one has the right to abandon it (i.e., one has to be permitted to get rid of it, e.g., give it to another). And if one has the right to use property, this implies that others cannot take the property without obtaining the owner's consent.

Second, as Barnett notes, the right to exchange titles to property allows a price system to arise. Yet as already noted, the price system promotes Barnett's goal of prosperity not because of knowledge dissemination but because of the crucial role of prices as accessories of appraisement. Third, permitting contractual transfer of resources promotes prosperity because both parties to a voluntary exchange are made better off (Rothbard 1997c).

Thus, it is the potential for interpersonal conflict and lack of objectively and justly defined property rights that endangers liberty, peace, and prosperity, not ignorance of others' preferences and local knowledge. Barnett's various "knowledge problems" are therefore better reformulated as "conflict problems." Libertarian principles would then be seen as ways to promote harmony and prosperity and to avoid conflict, instead of remedying the non-problem of deficiencies in knowledge.

The Second-Order Problem of Knowledge and the Rule of Law

"The *second-order problem of knowledge* is the need to communicate knowledge of justice in a manner that makes the actions it requires accessible to everyone" (p. 85). This is where the rule of law comes in. The rules of justice (i.e., substantive laws concerning private-property rights etc.) must be adequately *communicated* to individuals so that they can serve as guides to action and thus prevent conflicts. To ensure adequate communication, various "formal" requirements must be satisfied. These formal requirements—the rule of law—govern both the *form* of laws and *processes* by which they are generated and promulgated (p. 84).

For example, rules of conduct must be communicated ahead of time (ex *ante*); and they must also be sufficiently concrete to be applied in a variety of situations. These and other considerations lead to the conclusion that laws must be: "(a)

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general rules or principles that are (b) publicized, (c) prospective in effect, (d) understandable, (e) compossible, (f) possible to follow, (g) stable, and (h) enforced as publicized" (p. 107). Otherwise, a rule cannot serve as an operational guide to conduct, or will not be just.

Abstract Rights and Legal Precepts

As Barnett insightfully explains, principles such as private property, first possession, and freedom of contract are very *abstract*, and thus cannot serve to guide conduct except in relatively rare situations (pp. 84, also 85, 94–97, and 109–17). (Barnett refers to such abstract natural rights as "background" rights, as opposed to the actually existing or enforced laws or rights, which he refers to as legal rights. It is background rights to which legal rights *should* conform [p. 16]). Thus, any legal system must develop a body of specific or concrete legal rules or principles, based on or at least compatible with more abstract background rights. Barnett refers to the particular, concrete rules or principles that serve as guides to action as *legal precepts* (pp. 94–95).[23]

This analysis is on the mark, because it is true that legal principles must be *known* (communicated or published) and *operational* (sufficiently concrete) if they are to be used to avoid conflicts. The common tie between Barnett's second-order and first-order problems is therefore not *knowledge* but rather *conflict-avoidance*. A private-property order helps to avoid conflicts because each scarce resource is assigned a specified proper owner (reformulated first-order analysis). For conflicts to actually be avoided by individuals respecting these rules, however, the various rules as well as actual property boundaries must of course be *known*: I cannot consciously avoid trespassing on your property unless I know it is property and that trespassing is impermissible.

As a practical matter, this requires the rule of law be followed, and that legal rules be concrete enough (Barnett's legal precepts) to serve as operational guides to action. This problem is in a sense inherent in the very idea of a private-property order, because the latter cannot exist if no one *knows* what conflict-avoidance rules to follow, but it is a real problem nonetheless and deserves the attention Barnett gives it.

THE THIRD-ORDER PROBLEM OF KNOWLEDGE AND THE COMMON LAW

What kind of legal and political system guarantees (or at least makes it possible) that the rule of law will be followed? How will concrete legal precepts be developed? (Barnett does not ask how the abstract natural or background rights are to be developed; presumably through the writings of academic specialists like Barnett.) Clearly, some institutional means of providing such concrete private-property rules is

[23]On the objective function of property rules, see Hoppe (1989b; 1993); see also Barnett (p. 101): "Only a general reliance on objectively ascertainable assertive conduct will enable a decentralized system of rights to perform its allotted boundary-defining function."

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needed. This is where a decentralized law-generation process such as the common law steps in.

In chapter 6, Barnett expands the conception of the rule of law to include the way in which a body of legal precepts is developed. According to Barnett, the "*third-order problem of knowledge* is the need to determine specific action-guiding precepts that are consistent with both the requirements of justice and the rule of law" (p. 108). Again, I would characterize this as related to conflict-avoidance, rather than knowledge. In order to avoid conflicts, concrete private-property rules must be developed by some institution, and the institution must be such that the rules developed are just.[24]

Barnett first maintains that there are limits to the ability to deduce specific legal precepts from abstract principles of justice (natural rights), in part because many sets of legal precepts are consistent with the general parameters of the abstract principles of natural rights (pp. 109–11). He argues that a common-law type decentralized legal system, unlike law professors and philosophers, can develop legal precepts because, in such a system, they gradually develop and evolve from the outcomes of thousands of actual cases.

Yet, Barnett does not provide a rigorous argument showing where are the exact *limits* of the ability to deduce concrete rules. He evidently feels that the more abstract principles can, for some reason, be established by armchair theorists. If denizens of the ivory tower can do this, why can they not deduce or establish more concrete rules by simply considering more and more contextual facts? In the Roman law system—a somewhat decentralized legal system superior in many ways to the common law—Roman jurists (jurisconsults) helped develop the great body of Roman law by providing opinions on the best way to resolve disputes. These disputes were often purely hypothetical or imaginary cases, in which the jurists asked: "under such and such a possible or conceivable combination of circumstances, what would the law require?"[25] It is conceivable that a large part or even all of the legal code existing in a given society can be "deduced" in this fashion, and then these rules applied like precedents to actual controversies as they arise. As a libertarian (and, I confess, a lawyer), I must say that I believe I would be more comfortable living under a set of concrete rules deduced by libertarian philosophers than the (perhaps more concrete) set of rules developed under the actual common law.

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[24]Just rules are those that conform to the type of private-property order that serves to permit conflict avoidance and enable prosperity. As Hoppe has shown, such a private-property order is based on Lockean type homesteading since the first-possessor rule is the only objective rule that can be intersubjectively and universalizably agreed upon by potential disputants. See Hoppe (1989b, p. 131).

[25]Hadley (1996, p. 66) goes on to note that "A recent able lecturer on ancient law, Mr. Maine, finds in this fact an explanation of the more thorough scientific development which distinguishes the Roman law from the English." See also Frier (1985, pp. 163–71), Jolowicz (1952, p. 93), Buckland and McNair (1965, pp. 6–15, esp. 9). Barnett notes the similarity between common-law and civil-law legal systems (p. 115, 10n). The civil law was derived from principles developed in a common-law fashion in the Roman law. It is the Roman law, more than the more positivistic and legislation-worshiping civil law, that bears a similarity with the common law. See Kinsella (1995, pp. 135–36).

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Still, Barnett's argument in favor of a common-law system makes sense, even to libertarians who favor a deductive approach to rights (Hoppe 1989b, p. 131; Rothbard 1998; Kinsella 1997, pp. 607–45). Legal rules must be concrete in the sense that the rules must take into account the entire relevant factual context. Since there are an infinite number of factual situations that could exist in interactions between individuals, a process which focuses on actual cases or controversies is likely to produce the most "interesting" or useful rules.[26] It probably makes little sense devoting scarce time and resources to developing legal precepts for imaginary or unrealistic scenarios. If nothing else, a common-law type system that develops and refines legal precepts as new cases arise serves as a sort of filter that selects which disputes (i.e., real, commonly-encountered ones) to devote attention to.

Barnett thus makes a convincing case that, in a decentralized legal system such as the English common law (or the early Roman law, the Law Merchant, and even modern arbitral systems)—especially one in which judges or arbitrators attempt to apply fundamental notions of justice to concrete situations—it is reasonable to expect a body of concrete legal concepts and precepts to develop, which are more or less compatible with fundamental notions of justice.[27]

If and when unjust legal precepts do arise, they are not necessarily permanent because a common-law process allows them to be modified or replaced when this becomes apparent. However, unless it is clear that a given legal precept is inconsistent with justice, then there should be reluctance to jettison established legal rules or precedents. This thus gives rise to the legal doctrine of *stare decisis* (or *jurisprudence constante* in continental or civil-law systems) (Kinsella 1994, p. 1278).

This leads Barnett to make the provocative (for libertarians) argument that the "legal rights generated by a sound legal process may even be entitled to *presumptive legitimacy*" (p. 22, emphasis added; also p. 130),[28] and thus can even assist in determining the content of our background rights. We can always subject concrete legal precepts developed by courts to the scrutiny of the more abstract principles of justice and natural rights. This can help identify legal precepts "that are . . . inconsistent with either justice or the rule of law or both" (p. 110).

One question that bears exploring in this regard is exactly *how libertarian* are the abstract principles of justice that have been followed throughout the ages by judges and jurists of the common law, Roman law, and Law Merchant? In other words, just how libertarian are the legal precepts actually developed historically, and just how strong is the presumption of legitimacy which is to be accorded to

[26]This is analogous to Mises's method selecting certain empirical assumptions (e.g., assuming there is money instead of barter) to develop "interesting" laws based on the fundamental axioms of praxeology, rather than irrelevant or uninteresting (though not invalid) laws. See Mises (1962, p. 41; 1981, pp. 14–16, 30–31, 87–88; 1966, pp. 65–66).

[27]For further discussion of decentralized legal systems and related matters, see Kinsella (1995).

[28]For conventional views regarding the duty to obey laws promulgated by the state, see Smith (1973, pp. 950–76) and Green (1996, p. 15).

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these extant bodies of law? Which concepts of the common law are illiberal enough, when compared to Barnett's carefully-developed abstract principles of justice, to overcome the presumption of legitimacy? And how did the common law happen to employ more or less correct abstract principles of justice even before modern libertarian theory? Are these principles intuitive? Was it luck? Natural selection? Barnett does not answer these questions, but cannot be criticized for not doing everything.[29] Libertarian law students and scholars looking for topics to research, pay heed!

Problems of Interest and Power

After discussing the problems of knowledge (better characterized as conflict-avoidance, as noted above), Barnett turns to problems of *interest* and *power*. The problems of interest concern how individuals balance questions of incentive, compliance, and partiality in access to resources. The problems of power are the possibility that there will be error and abuse in applying or enforcing legal precepts. Barnett elaborates on these challenges, and shows how each of them is addressed by the libertarian conception of justice and the rule of law.

Most of Barnett's arguments concerning interest and power are more straightforward than those regarding knowledge in Part 1, even where Barnett tries to support his arguments by referring to various knowledge-related aspects of the issue at hand. Barnett's discussion of the "problem of partiality," however (the first problem of interest), seems overly muddled due to the preoccupation with knowledge. Barnett claims that there is a "partiality problem" which "arises from the fact that people tend to make judgments that are partial to their own interests or the interests of those who are close to them at the expense of others" (p. 136). This partiality "leads to a tendency to favor one's own interest"; partiality "is judgment affected by interest" (p. 137). Maybe I am slow, but I cannot see what is the alleged problem here. This seems to be nothing more than the unavoidable fact of self-interest. Of course people are partial to themselves. What is wrong with this? I see no need for people to take "into account the partial interests of others" (p. 137). So long as others' property rights are respected, it seems to me that one ought to be able to be as "partial" as one likes without others complaining about it.

Barnett's discussion of the other problems of interest and the problems of power, though, are much more fruitful and less tainted by the occasional and vain attempt to link it to the Hayekian knowledge paradigm. For example, it is certainly true that the incentives (chap. 8) which are provided under capitalism are very useful and are missing under socialism. And there is indeed a need to ensure *compliance* (chap. 9) with private-property rules, e.g., by using force for self-defense, restitution, and punishment (pp. 176, 184, 191). I see no strong reason to call these problems of "interest," although the label seems harmless enough.

[29] But see his discussion on pp. 122–23.

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And (Part 3), there are indeed dangers involved in the use of power, such as the possibility of *error* in enforcement and punishment (chaps. 10 and 11), and abuse of the power of law enforcement (chap. 12). Many of Barnett's arguments here are very insightful and persuasive (some discussed below), although again, I find most of them to be so *despite* the superfluous comments on knowledge. In fact, I found the last half of the book (chaps. 9–15), which bears less and less on the knowledge paradigm introduced at the beginning, to be the most fascinating and best part of the book (plus the discussion of the common law in chap. 6).

Restitution vs. Retribution

One interesting argument that Barnett makes, with regard to enforcement error and abuse, is that all criminal justice should be restitutive, not punitive or retributive. As I have argued elsewhere,[30] I believe Barnett is mistaken that retribution (punishment) violates the *rights* of (actually guilty) aggressors.[31] However, in keeping with his consequentialist approach which avoids questions of justification of fundamental norms, Barnett does not pretend to make a strong theoretical case for the rights of aggressors to be free from punishment.[32]

Indeed, most of Barnett's concerns regarding punishment are warranted: he opposes it because he believes it may deter crime less than would a restitution-based system, and also because the unavoidable possibility of error can lead to "infliction of harm on the *innocent*" (p. 228, emphasis added; also pp. 197, 228). Like Barnett, I am concerned about the unavoidable possibility of mistakenly punishing the innocent, and thus admit the appeal of a restitution-based system in order to avoid punishing innocents. Moreover, Barnett makes a powerful and original argument for why the *standard of proof* should be higher if a victim seeks to punish a purported aggressor rather than merely obtain restitution (p. 212). Thus, a victim seeking to punish the aggressor must prove guilt beyond a reasonable doubt, whereas the lower standard of preponderance of the evidence is more appropriate for a civil trial for damages. It is therefore *more costly* to seek punishment than to seek restitution. For this and other reasons, restitution would probably become the predominant mode of justice in a free society.

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[30]Kinsella (1998–99, pp. 79–93); for more on the theory of inalienability, including discussion of Barnett's views in this regard, see Kinsella (1999) and Block (forthcoming).

[31]For justification of the right to punish aggressors, see Kinsella (1997; 1996, pp. 313–26) and Hoppe (1989b, p. 131).

[32]As Barnett acknowledges, "this analysis cannot conclusively prove that no combination of compensation or punishment can ever address effectively the compliance problem" (p. 237). And further: "I do not claim to have completely demonstrated this proposition [that justice requires restitution, not punishment] either in my earlier writings, or in this book" (p. 185 n. 36). See also, pp. 228, 320, 321: "If men were gods, then perhaps imposing rewards and punishments on the basis of desert would be a workable theory." Also: "It has been noted that one who wishes to extinguish or convey an inalienable right may do so by committing the appropriate wrongful act and thereby forfeiting it" (Barnett 1986b, p. 186). As I noted in (Kinsella 1998–99) Smith (1996, p. 46) is incorrect in claiming that Barnett's writings support Smith's view that all rights, even those of a murderer, are inalienable.

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Nevertheless, acknowledging (and justifying) the theoretical legitimacy of punishment can be useful. For example, punishment (or a theory of punishment) may be utilized to reach a more objective determination of the proper amount of restitution,[33] because a serious aggression leads to the right to inflict more severe punishment on the aggressor, which would thus tend to be traded for a higher average amount of ransom or restitution than for comparatively minor crimes.[34] Especially offended victims will tend to bargain for a higher ransom; and richer aggressors will tend to be willing to pay more ransom to avoid the punishment the victim has a right to inflict, thereby solving the so-called "millionaire" problem faced under a pure restitution system (where a rich man may commit crimes with impunity, since he can simply pay easily-affordable restitution after committing the crime).

Moreover, even if punishment is banned (*de facto* or *de jure*) and is not an actual option—because of the possibility of mistakenly punishing innocents, say—an award of restitution can be *based* on the model of punishment. To-wit: a jury could be instructed to award the victim an amount of money it believes he *could* bargain for, given all the circumstances, *if* he could threaten to proportionately punish the aggressor. This can lead to more just and objective restitution awards than would result if the jury is simply told to award the amount of damages it "feels" is "fair." Barnett nowhere specifies any objective standards or criteria by which a judge or jury is to determine the amount of restitution a victim is to receive for a non-economic crime like murder, rape, and the like. He specifies only that the aggressor must "compensate" the victim for the "harm caused," to "restore" the victim (pp. 159, 185). Thus, a retribution-based system, even if used only as a model to help determine the amount or standard of restitutive damages, supplements Barnett's theory of a restitution-based justice system.

Preventative Force

Barnett makes a convincing case that the principle of "extended self-defense" justifies imprisoning (sometimes for life) those who have made a sufficiently unambiguous communication of a threat to another (pp. 186–91). Because of the possibility of enforcement abuse and rule of law considerations, however, Barnett would limit this remedy to those persons who have communicated a threat to others by their past criminal behavior (i.e., those who have been convicted, perhaps multiple times, of a crime), and only if the previous crimes were proved beyond a reasonable doubt (pp. 213–14).[35]

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[33]On the issue of determination of the proper amount of damages, see Benson (1996, pp. 79-83) and Rothbard (1998, pp. 88–89).

[34]For further discussion of criminals buying their way out of punishment, see Kinsella (1998–99; 1997, p. 635); Rothbard (1998, pp. 86, 89); Pilon (1978, p. 356).

[35]See also Barnett (1996, p. 157). One problem with Barnett's solution here is that, under his restitution-based system, previous crimes would have been proved by some standard less than the "beyond a reasonable doubt standard," such as the "preponderance of the evidence" standard, and thus it would be very difficult to jail threatening individuals.

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This limitation on the principle of extended self-defense seems to me to be unduly restrictive, however. In my view, a threat can be viewed as a species of the crime of *assault*. Assault is defined as putting someone in fear of receiving a battery (physical beating).[36] A threat should count as a type of assault because the threatener puts the victim in fear of receiving a battery, and also deliberately increases the likelihood of physical harm befalling the victim. As explained elsewhere (Kinsella 1997, pp. 639–40), assault may be punished because this is the only way the victim can reciprocate and put the aggressor-threatener in a like state of fear. I see no reason to allow extended self-defense only where the aggressor has previously been convicted of a crime. Even the first crime is a crime.

POLYCENTRISM—I MEAN, ANARCHO-CAPITALISM

One of the best parts of *The Structure of Liberty* is its argument in favor of anarcho-capitalism. It is marred by its strict avoidance of the more appropriate terms anarcho-capitalism or anarchy; Barnett for some reason prefers to describe anarcho-capitalism as a "polycentric constitutional order," presumably to avoid unduly alienating statist readers. (If he feels polycentric is a better term than anarcho-capitalism, he does not offer reasons.)

Barnett notes that various types of structures have been tried "to deal with the problem of enforcement abuse by a coercive monopoly of power," i.e., government, including elections, federalism, and free emigration. Yet, he recognizes, these have failed to keep government in check. Thus, he argues that each of these three principles "reflects a more fundamental principle that needs to be more robustly incorporated into institutional arrangements: *reciprocity, checks and balances,* and the *power of exit*" (p. 256).

Barnett elaborates on these in chapter 13, one of the best in the book. He notes that two constitutional principles are sufficient to achieve a polycentric order: *nonconfiscation* and *competition*. Under the former, "[l]aw-enforcement and adjudicative agencies should not be able to confiscate their income by force, but should have to contract with the persons they serve." Under the latter, they "should not be able to put their competitors out of business by force" (p. 258). As is clear to libertarians, adherence to these two principles would indeed result in the anarcho-capitalist society, for no government can exist without the ability of a coercive monopoly over its services.[37]

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[36] *Louisiana Criminal Code* § 36; *Black's Law Dictionary* (1994, p. 114; defining assault); *Mason v. Cohn*, (1981; defining assault). The Louisiana Criminal Code defines assault as "an attempt to commit a battery, or the intentional placing of another in reasonable apprehension of receiving a battery." A battery is defined as "the intentional use of force or violence upon the person of another; or the intentional administration of a poison or other noxious liquid or substance to another." *Louisiana Criminal Code* § 33. Assault can thus also include an attempted battery (which need not put the victim in a state of apprehension of receiving a battery—e.g., the victim may be asleep and be unaware that another has just swung a club at his head, but missed).

[37] Charles Murray (1997, p. 64) makes a similar point when he argues that citizens should be able to opt out of certain government programs.

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Barnett makes several excellent points in chapter 13. He notes, for example, that if an individual refuses to contract with any legal system, force can still be used against him if he harms others. "The justice of using force against such a person is based on the fact that he or she violated the rights of the victim, not that he or she consented to the jurisdiction of a court" (p. 278). It is refreshing to see this point emphasized, because many advocates of anarcho-capitalism seem to feel that an aggressor can be punished by a defense agency only if the aggressor somehow previously consented to the jurisdiction of the agency (if he did not consent, the only permissible remedy is presumably ostracism).

Another excellent point concerns the likelihood of a polycentric order actually embodying liberal norms. Barnett sensibly points out that

> it is difficult to imagine a society that did not adhere to some version of a liberal conception of justice ever accepting a polycentric constitutional order in the first instance. A societal consensus supporting these rights and remedies would seem to be a precondition for ever peacefully ending [monopoly government power]. And, once adopted, the inherent stability of the robust "checks and balances" provided by a competitive system is likely to preserve this initial consensus. (pp. 281–82)

Finally, my favorite part of the book is the well-written, thoughtful, and imaginative chapter 14, "Imagining a Polycentric Constitutional Order: A Short Fable," in which Barnett speculates on what a possible polycentric-ordered society might look like and how it might function. I mean, an anarcho-capitalist society.

TERMINOLOGY

It is clear that Barnett is a libertarian and that *The Structure of Liberty* is thoroughly infused with libertarian principles with regard to rights, government, and economics. He even goes so far as to advocate a polycentric—i.e., anarcho-capitalist—system. But one irritating aspect of the book is the unconventional and idiosyncratic use of terminology. Some of these terms seem to be used to try to avoid alienating statists. It is understandable—but ultimately futile, in my view—why Barnett might want to soften the blow of loaded terms like libertarian and anarchy, and use the kinder, gentler (but blander, less descriptive, and more misleading) terms liberal and polycentric instead.[38] In my view it is preferable to call a spade a spade.[39] We won't fool anyone into supporting anarcho-capitalism by using a fancier term.

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[38] At least the book is not loaded with the recent term "market liberal," which is, thankfully, withering on the vine.

[39] See Rand (1964, p. vii):

> The title of this book [*The Virtue of Selfishness*] may evoke the kind of question that I hear once in a while: "Why do you use the word 'selfishness' to denote virtuous qualities of character, when that word antagonizes so many people to whom it does not mean the things that you mean?" To those who ask it, my answer is: "For the reason that makes you afraid of it."

Rand also unabashedly, and admirably, proclaimed herself to be a radical for capitalism.

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Some of the terms employed, such as "several property" and "polycentric" order, clearly reveal the Hayekian influence on Barnett; other Hayekian terms such as "spontaneous" and "coordination" are also sprinkled throughout the book. Nothing seems to be gained except confusion and lack of clarity by replacing perfectly good terms like private property and anarcho-capitalism with inferior terms, or even with equally conceptually valid terms.

Barnett also uses the expressions "background rights" instead of natural rights; and "legal precepts" instead of "concrete legal rules" or some other such descriptive term. I must admit that I like having a term for operational, concrete legal rules as distinct from more abstract principles; and "legal precepts" seems, I suppose, as good as any. But "background rights" does not seem to be an improvement over terms such as natural or moral or individual rights (or just plain "rights"). However, these quibbles mainly relate to Barnett's strategy or style, not to the substance or soundness of his arguments.

PROBLEMS WITH THE PROBLEMS

A consequentialist analysis can be valuable, but one difficulty with Barnett's account is that he presumes that the universally shared goals of peace, prosperity, and happiness can be achieved if only we solve *three* main problems (of knowledge, interest, and power). I have already explained that the Barnettian problems of knowledge are better reformulated as aimed at conflict-avoidance, and thus peace (and perhaps at enabling economic calculation, and thus prosperity). A deeper question is why are these the only problems that get in the way of our goals? Why are these three problems exhaustive? What about other purported problems harped on by communitarians, socialists, or other consequentialists, such as inequality and poverty, commercialism and consumerism? Barnett's considers this issue (pp. 325–26), but provides only a brief and somewhat unconvincing argument that addressing these other problems with legal coercion would undermine the "foundations" of the "structure of liberty" and thus prevent the three fundamental problems from being solved.[40]

CONCLUSION

As is often the case in a review of this sort, many of my comments have been critical, but this should not give the impression that I find fault with the bulk of Barnett's work. I have focused primarily on the aspects with which I disagree, and have emphasized economic calculation and the Hayekian knowledge paradigm, and have largely omitted discussion of the many valuable ideas in *The Structure of Liberty*. In fact, I have profited immensely from many of Barnett's previous theories, such as his views on constitutional interpretation, contract theory, and his tantalizing suggestion that there should be a presumption against the legitimacy of government statutes in derogation of common law or liberties—a "presumption of liberty" (1995; 1993). Most of these

[40]For a similar critique of Barnett's argument in this regard, see Solum's (1999, pp. 1791–92) review of *The Structure of Liberty*.

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are not included or discussed at length in this treatise. Luckily, Barnett's next book is reportedly *The Presumption of Liberty: Restoring the Constitution* (Mingardi 1999).

The Structure of Liberty is an important new work by one of libertarianism's most significant and thoughtful legal scholars. Its primary substantive deficiency is its over-reliance on the Hayekian knowledge paradigm, but the work nonetheless arrives at the private-property norms that address the more relevant issue of interpersonal conflict. The book is full of subtle insights regarding standards and burdens of proof, restitution, the workings of the common law, and the operation of anarcho-capitalism. It is must-reading for all serious libertarian theorists, especially libertarian lawyers and legal theorists.

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AUSTRIANS AND POST KEYNESIANS: THE QUESTIONS OF IGNORANCE AND UNCERTAINTY

GREGORY M. DEMPSTER

Uncertainty in Economic Thought. Edited by Christian Schmidt. Cheltenham, U.K.: Edward Elgar, 1996

What makes Austrian economics distinctive in relation to other schools of thought? Various aspects such as subjectivism, praxeological method, and the absence of modeling have been put forward as "defining characteristics" of the school. And, since they are not mutually exclusive, each has considerable merit, for each is an attempt to grasp the essence of a "core" concept that distinguishes the Austrian approach from the formulaic, deterministic, and positivist approach of the mainstream. In this article, we will attempt to demonstrate that the Austrian method of dealing with both theory and history is informed by its perspective on uncertainty as the core concept uniting the various characterizations of Austrian thought. Furthermore, we will argue that the Austrian School, among modern schools of thought, possesses the most realistic perspective on uncertainty and its role in the functioning of the economic system.

The occasion for this article is a review of *Uncertainty in Economic Thought*, edited by Christian Schmidt (1996). The book is a collection of articles, primarily by continental economists, presented at a 1993 symposium of the Charles Gide Association for the Study of Economic Thought. Austrian scholars interested in the subject matter will benefit not only from its discussion of the shortcomings of mainstream economics in this area, but even more so from articles that present the essential elements of the two most prominent non-mainstream approaches: those of the Austrian and Post Keynesian Schools. It is the relationship between these two non-mainstream approaches that will be the focus of this article.[1]

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[1]Other economists of Austrian orientation have researched the Post Keynesian school in some detail. See, for example, Bellante (1992). Hoppe (1997) summarizes Mises's analysis of the risk-uncertainty distinction.

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Such an emphasis is justified, from an Austrian perspective, because of numerous suggestions made that the two schools would benefit from some sort of "increased intellectual trade." For instance, no less an authority than John Hicks has "made a case for increased integration" of the viewpoints of John Maynard Keynes and F.A. Hayek (Snowdon, Vane, and Wynarczyk 1994). The Austrians and Post Keynesians, in addition to their criticisms of orthodoxy on the issue of uncertainty, also share non-mainstream perspectives on the importance of monetary institutions (as opposed to strict money neutrality) and transitional states (as opposed to static equilibrium). However, despite their shared recognition of important factors such as ignorance, money, and time, the two schools remain far apart on the nature and significance of these factors within the economic system.

Approaches to Uncertainty: Development and Evolution

In the first chapter of *Uncertainty in Economic Thought*, Mark Perlman and Charles McCann consider the "bundle of ideas" that make up the modern conception of uncertainty. Their chapter serves as a useful summary of the development of the uncertainty concept in the history of thought. The authors note, for example, that Richard Cantillon, considered one of the forerunners of the subjectivist approach later adopted by the Austrians, was among the earliest economic thinkers to stress the entrepreneurial decision of committing known costs against unknown (i.e., future) prices. In discussing the ability of the entrepreneur to account for future contingencies, J.H. von Thünen held that profit accrues as a payment for the willingness of the entrepreneur to take on uncertainty beyond that which is discountable (i.e., measurable risk, which corresponds to knowledge of a probability distribution of future outcomes).[2] Thus, the term uncertainty applies to cases where it is not known whether any such distribution exists (p. 12).

Augustin Cournot also wrote extensively on the problem of uncertainty. Perlman and McCann summarize Cournot's view of uncertainty as stemming from two sources: (1) faulty perceptions and (2) the specificity of events (p. 13). The first of these two sources may be seen as the rationale for an approach based on "subjective" probabilities, i.e., the notion that, although the "true" probability distribution of outcomes may not be known to a decisionmaker, he nonetheless forms a subjective distribution of outcomes based upon the set of information available at the time of choice. The second source, on the other hand, corresponds closely to von Thünen's view and to modern, non-mainstream conceptions of uncertainty.

In essence, mainstream economics has followed the lead of neoclassical theorists John von Neumann, Oskar Morgenstern, Leonard Savage, and others (including, arguably, Robert Lucas, Jr.) in classifying uncertainty as merely

[2]Von Thünen is popularly credited with formally distinguishing "true" uncertainty from risk (p. 12).

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unidentified risk (pp. 11, 14–15). Non-mainstream schools such as the Austrians and Post Keynesians, on the other hand, have insisted on the theoretical distinction between the two. An important result of these different approaches is that the mainstream position has proven especially conducive to the "strong" form of rational expectations, whereby the subjective and objective probability distributions of all economic outcomes are identical, while the non-mainstream positions have allowed significant scope for the "non-convergence" of subjectively formed expectations and objectively determined outcomes.

Almost all non-mainstream approaches to uncertainty draw heavily from Frank Knight (1921). Several chapters in *Uncertainty in Economic Thought* are devoted to further illumination of Knight's treatment. Knight "mostly repeated von Thünen," say Perlman and McCann, but then added to von Thünen's analysis the concept of entrepreneurial insight. The reward, says Knight, for correct (in hindsight) entrepreneurial decisions in the face of "unforeseen risks" is profit (p. 13). This perspective on uncertainty fits well with the Austrian emphasis on the entrepreneur and the division of knowledge. Indeed, the Post Keynesian Paul Davidson, in the book's second chapter, includes Knight among the Austrians in relation to the treatment of uncertainty and risk (p. 22). Other articles examine the interpretation of Knight's treatment and its relation to corresponding developments in the work of Keynes, Hayek, Hicks, and G.L.S. Shackle.

Approaches to Uncertainty: Austrian and Post Keynesian

To its credit, *Uncertainty in Economic Thought* gives the Austrians their due in regard to the treatment of uncertainty in economic life; the introduction notes, for instance, that "uncertainty is a logical implication of the methodological options of the Austrian School" (p. 3). Attention is given to Hayek's emphasis on the diffusion and incompleteness of knowledge as well as to Menger's analysis of how the use of money is both a response to and a generator of uncertainty.[3] The best discussion of Austrian ideas in the collection, however, is Pierre Garello's chapter examining the link between subjectivism and uncertainty in Austrian thought.[4] Garello uses Mises's *Human Action* (1949) as his basis for a discussion of the role of uncertainty in Austrian economics, a role that is found to be fundamental. Indeed, Mises himself writes

> The uncertainty of the future is already implied in the very notion of action. That man acts and that the future is uncertain are by no means two independent matters. They

[3]On Hayek, see Omar Hamouda and Robin Rowley, "Ignorance and the Absence of Probabilities" (pp. 38–64). On Menger, see Thierry Aimar, "Money and Uncertainty in the Economic Thought of Carl Menger" (pp. 100–11). Aimar's portrayal of Menger's thought lends support to the view, shared by the present author, that Menger was much more eclectic in his approach to economic science than many modern-day Austrians seem to realize (or, perhaps, care to admit).

[4]"Uncertainty and Subjectivism: The Role of Uncertainty in the Austrian School" (pp. 87–99).

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> are only two different modes of establishing one thing . . . If man knew the future, he would not have to choose and would not act. (Mises 1949, p. 105)

A key to understanding uncertainty in an Austrian context is that it is not merely the ends toward which actions are directed that are subjectively determined, but the means as well. Neoclassical economics accepts the subjectivity of ends (i.e., tastes and preferences), but has no truck with the subjectivity of means. By contrast, as Garello points out, the Austrians insist that

> only *ex post* can we be sure that the use of such and such means enables us to reach our ends. At the time the decision is made, the results are uncertain because they will occur in the future, even if it is the very near future. (p. 89)

Thus, it is "because economic phenomena are the consequences of actions, which themselves rest on subjective bases, that uncertainty naturally turns into a fundamental element of economic life and therefore of economic analysis" (p. 88). As economic scientists, we must realize that we cannot, with certainty, identify either the goals of economic actors or even the means by which they perceive those goals may be met.

This does not imply that neither economists nor the economic agents that are the focus of their attention have any method by which to proceed in their analysis of future possibilities. Economists can make use of their understanding of human action and corresponding market processes to study "events (past actions) in their uniqueness, their specificity" (p. 91). The goal of such historical (as opposed to praxeological) research is to address the "quantitative problems" in the field of action. Says Mises,

> Quantitative problems are in the field of human action open to no other elucidation than by understanding. . . . Understanding, by trying to grasp what is going on in the minds of the men concerned, can approach the problem of forecasting future conditions. (Mises 1949, p. 118)

Economic agents, too, make use of their understanding of human action. Garello quotes Mises:

> Understanding is not a privilege of the historians, it is everybody's business. In observing the conditions of his environment everybody is a historian. . . . Acting man looks, as it were, with the eyes of a historian into the future. (ibid., p. 58)

In fact, it is in this role as an economic actor that the scientist gains insight into the "quantitative problems" of economic relations.

Of particular relevance to the Austrian perspective on uncertainty is the role of the entrepreneur. As Garello states, the "concept of entrepreneurship is at the root of the Austrian theory of market processes" (p. 92). And it is here, where entrepreneurship enters the picture, that the Post Keynesian treatment of uncertainty may be usefully introduced and contrasted with the Austrian approach. For while the two schools agree essentially on what uncertainty *is* (vis-à-vis the neoclassical

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mainstream), they are quite far apart in terms of what uncertainty *means* for economic actors and for the scientists who try to make sense of their actions. The point of departure rests on the role of the entrepreneur or, more correctly, on the lack of entrepreneurial function (in the Austrian view) within the Post-Keynesian framework.

How, in a world of uncertainty and change, do economic actors somehow manage to achieve a reasonable degree of coordination among their individual plans? The means-ends framework that characterizes human action provides the answer to this question, and it is the entrepreneur that is the driving force behind the coordinating process. Successful entrepreneurs are those who, through alertness and insight, are able to detect the presence of discoordination (or, if you prefer, disequilibrium) in markets and act upon this insight in order to make profits. This insight is defined by Hayek as "a capacity to find out" based on the (local) knowledge of the particular circumstances of time and place "which kinds of things or services are wanted, and how urgently they are wanted" (Hayek 1978). The test of whether such decisions are, in fact, coordinating (or equilibrating) is to be found solely in the *ex post* disposition of profit and loss. And it is entrepreneurial decisionmaking in the face of uncertainty and in the hope of profit that leads to the very possibility of coordinating market processes.[5]

Post Keynesian writers such as Davidson implicitly deny the importance of this coordinating aspect of entrepreneurship.[6] His entry in *Uncertainty in Economic Thought*[7] is an attempt to clearly distinguish the Post Keynesian position on uncertainty from other positions. Quoting Keynes, Davidson defines uncertainty as the absence of any "scientific basis on which to form any calculable probability whatever" (p. 23). And lest we mistake this to be merely an assertion that economic scientists are incapable of knowing beforehand the means and ends on which subsequent human actions are based, Davidson clarifies:

> For Keynes and the Post Keynesians, on the other hand, uncertainty involves situations where decisionmakers believe that no relevant probabilities (no external reality) exist today that can be used as a basis for scientifically predicting future events. As John Hicks has put it "One must assume that people in one's models do not know what is going to happen, and know that they do not know what is going to happen." . . . This Keynes–Post Keynesian view permits human "free will" to create future outcomes (or future states of the world) . . . It is truly a revolutionary way of looking at the entrepreneurial market system. (pp. 24–25)

[5]Garrison (1986) demonstrates the importance of particular institutional arrangements, i.e., those that reward "correct" expectations and penalize "incorrect" expectations, in bringing about market coordination.

[6]Perhaps a caveat applies here. Post Keynesian writers are a diverse lot, as much or more so than the Austrians, although sharing a basic emphasis on the imperfection of knowledge as well as markets. We, therefore, do not presume to imply that all Post Keynesians share the views of Davidson, the writer critiqued in this chapter. As a leading figure in Post Keynesian thought, however, Davidson can be fairly considered a "representative agent" of the school.

[7]"Some Misunderstandings on Uncertainty in Modern Classical Economics" (pp. 21–37).

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In contrast to this Post Keynesian approach, Davidson characterizes the Austrian approach as one in which "external reality is determined by Mother Nature in a manner similar to the way nineteenth-century physicists viewed the working of the physical world" (p. 24). As such, the Austrian approach fails to provide "room for human free will and the creative aspect of human nature and entrepreneurship" and, instead, posits a world where the "economic play is already written in the laws of economic nature that determine the economy's structure, just as the future paths of the planets are predetermined by the laws of physics" (p. 26).

Given that Davidson does not provide even a single reference to writings of an Austrian economist that actually attest to his characterization of their approach, we will not bother to refute it here.[8] In essence, the question of whether the future is predetermined is irrelevant from an Austrian standpoint; it is enough to know that "to acting man the future is hidden" (Mises 1949, p. 105). The more fundamental conflict between the two schools concerns competing visions of what entrepreneurs actually do. Austrians will agree that if "entrepreneurs have any important function in the real world, it is to make crucial decisions" (p. 32). Davidson fails to speculate, however, as to just how entrepreneurs might go about making such decisions in the face of an uncertain future. As noted before, the Austrian approach is explicit about the role of alertness and insight, based on localized knowledge, in driving the entrepreneurial decisionmaking process. By contrast, the most Davidson can find to say about entrepreneurial decisionmaking is that entrepreneurs "will sensibly disregard available market price signals" if they believe that conditions "will cause the future to differ in a nonpredictable (uncertain) way" (p. 29).

Now, certainly the very fact that an entrepreneur acts is enough to inform us that he is not disregarding price signals. To the contrary, the acting entrepreneur is one who has come to the decision that available market prices are signaling an opportunity for profit, a temporal disequilibrium that may be exploited to the gain of the one who correctly appraises the situation and acts accordingly. Of course, there need be no presumption on the part of the economic scientist that entrepreneurs will have, on balance, expectations that correspond to the reality that unfolds (as the "strong" form of rational expectations predicts). We can be certain only of the fact that those who prove (from hindsight) to have made incorrect decisions will incur economic losses, while those who prove to have chosen correctly will reap economic gains. Thus, the market systematically and impartially "weeds out" errors and coordinates the plans of individuals who hold widely disparate expectations of the future. The very essence of entrepreneurship

[8]Let it suffice to say that this characterization of the Austrian approach is, well, amusing. Compare with Mises:

> from the human point of view action is the ultimate thing. We do not assert that man is "free" in choosing and acting. We merely establish the fact that he chooses and acts and that we are at a loss to use the methods of the natural sciences for answering the question why he acts this way and not otherwise. (Mises 1949, p. 105)

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is to act on the basis of "available market price signals" that indicate discoordination.

Davidson does not spend any time discussing why entrepreneurs would act if market prices were to be completely disregarded, but we can perhaps look to the traditional Keynesian diagnoses of "animal spirits" and the "propensity" to consume and save for answers. In a Keynesian world, there need be no particular insight, even of the localized and subjective sort, for action on the part of entrepreneurs. To the contrary, entrepreneurs are assumed to act on the basis of expectations that they know themselves to have no good reason to hold apart from some obscure collective psychology, naively assuming that the best guide to action is what everyone else is doing. Thus, while both the Austrians and Post Keynesians stress the importance of entrepreneurship in an explanation of economic phenomena, the Post Keynesian emphasis appears to be an entirely negative one, acknowledging the place of action without seriously considering the impetus for that action. And in emphasizing action without reference to the perceived knowledge that brings that action about, the Post Keynesian analysis actually undermines the "free will" to which it proposes to give place.

These very different views on the nature of entrepreneurship give rise to corresponding differences in policy prescriptions. For an Austrian economist, it is the presence of the entrepreneur that ensures a competitive "discovery process" in which economic actors attempt to change the current state of affairs, thereby "systematically contributing to the coordination of plans" (p. 93). The absence of the entrepreneurial function in the Post Keynesian framework, however, leads to the recognition of uncertainty in economic life without its market-based solution. It is unsurprising, therefore, that dealing with this rampant uncertainty becomes the foremost problem for Post Keynesian policy to solve. Their solution, which they naturally attribute to the brilliance of Keynes, is that government must step in with policies that reduce uncertainty and/or mitigate its effects.[9] Says Davidson,

> Government should be continuously seeking to develop, where possible, adaptable economic institutions that attempt to reduce uncertainties by controlling the economic environment to limit future time outcomes to those that are closely compatible with full employment and reasonable price stability. Economists should strive to design various institutional devices that can produce legal constraints on the infinite universe of events that could otherwise occur as the economic process moves through historical time. (p. 34)

In other words, although the market is itself unable to deal with the fundamental problem of uncertainty, society is, through government, "capable of producing policies that intelligently control and improve the performance of the economy compared to what would occur under laissez-faire competitive market conditions" (p. 25).

[9]Thus, Davidson quotes Keynes in his insistence on "a somewhat comprehensive socialization of investment" as the means for "securing an approximation to full employment" (p. 26).

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Thus, Post Keynesian policy recommendations involve limiting the legal ability of individuals to bargain in the marketplace. Such recommendations include traditional demand management and "incomes" policies designed to stimulate expenditures while stifling free wage bargaining (Snowdon, Vane, and Wynarczyk 1994, pp. 367–82). However, a glaring omission in Davidson's chapter is that the link from the Post Keynesian position on uncertainty to the possibility of government action to "improve the performance of the economy" is never made. Even if one accepts the view of an economy plagued by an all-encompassing uncertainty and entrepreneurs that act without any good reason for doing so, it still does not follow that government is capable of improving upon the results of this economic process.[10] In fact, the Post Keynesians' own vision of pervasive uncertainty would seem to lean against such conclusions, for how, in a world of such uncertainty, could the government possibly form policies that are compatible with full employment and price stability? Under uncertainty, there can be no perfect *ex ante* knowledge of the relationship between actions and particular outcomes. To claim that government can improve upon free-market outcomes by reducing uncertainty, one must somehow infer that the government is able to obtain information that is unavailable to market participants in regard to future prospects. If Davidson has some reason to believe that government does indeed have access to such information, it is not stated here.

CONCLUSION

We do not wish to imply that there is nothing of value in Davidson's presentation of the Post Keynesian approach to uncertainty. Nor do we believe that there is no possibility of fruitful dialogue on various aspects of the uncertainty problem between Austrians and Post Keynesians. Credit is certainly due to Davidson for his ability to frame the risk-uncertainty distinction in the language of modern, neoclassical theories of stochastic processes.[11] And, apart from the omissions we have discussed, most Austrians will find little to disagree with in his discussion of entrepreneurship and "crucial" decisions. Unfortunately, those omissions are of fundamental relevance to the whole issue of uncertainty. The strength of the Austrian approach is demonstrated in its close attention to the entrepreneurial function that other traditions, including the Post Keynesians, tend to ignore.

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[10] Mises makes a case for the opposite conclusion:

> All varieties of interference with the market phenomena not only fail to achieve the ends aimed at by their authors and supporters, but bring about a state of affairs which—from the point of view of their authors' and advocates' valuations—is less desirable than the previous state of affairs which they were designed to alter. (1949, p. 854).

Indeed, there are very credible arguments and evidence that intervention will tend to increase, rather than decrease, uncertainty. See, for example, Koppl and Yeager (1996).

[11] Austrians could, we think, take a cue from Davidson's treatment in this regard. The inability of Austrian economists to correspond with the mainstream via a "common dialect" is an often overlooked but important hindrance to the transmission of valuable ideas throughout the profession.

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MONOPOLISTIC COMPETITION AND MACROECONOMIC THEORY. BY ROBERT SOLOW. CAMBRIDGE, U.K.: CAMBRIDGE UNIVERSITY PRESS. 1998.

Robert Solow's *Monopolistic Competition and Macroeconomic Theory* is a short collection of three essays based on lectures that he gave at the University of Rome in 1996. Solow introduces the essays by asking: "How can one explain the fact that Keynesian ideas and methods have survived for sixty years despite their theoretical weaknesses and analytical crudities?" (p. 1). Good question. Solow offers two reasons for the survival of Keynesian ideas: (1) The "usual alternatives ask us to believe things that appear not to be true; and (2) Keynes's *General Theory* was premised on the assumption of perfectly competitive goods markets, and economists tend to be enamored of such models.

Reason number 1 seems farcical. It was *Keynesianism*, was it not, that argued that the state can spend us into prosperity, ignoring the concept of opportunity cost; taking a dollar from a citizen and having government spend it will magically turn it into more than a dollar (the "balanced-budget multiplier"); there is a tradeoff between inflation and unemployment; savings and capital accumulation are impoverishing because of the "paradox of thrift"; deficit spending is desirable; government debt is nothing to worry about because "we owe it to ourselves"; macroeconomic central planners will faithfully serve the "public interest" by "stabilizing" the economy and ignoring all political pressures; and countless other absurdities and falsehoods?

Solow doesn't name names when he criticizes "alternatives" (to Keynesian) theories other than to disparage "misperceptions stories." He could well be referring to the Austrian business cycle theory, however, with its emphasis on government-induced malinvestment. If so, it takes a great deal of *chutzpah* on his part to criticize this, or any, theory on the grounds that it is less realistic than Keynesianism. The author pathetically defends Keynesianism on the grounds that there are still economists who spend their time estimating "consumption functions, demand-for-money equations, and slow-price adjustment relations" (p. 3).

Solow may be on more solid footing in arguing that macroeconomists have invested a great deal of time in "modeling" goods markets as perfectly competitive and are hesitant to abandon their old ways. But he completely ignores what is perhaps the main reason why Keynesian ideas and methods have survived despite their "theoretical weaknesses and analytical crudities"—the rational self-interest of economists and policymakers.

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As explained by Keynes's biographer, Roy Harrod (1951, pp. 192–93), Keynes himself believed that "the government . . . was and could continue to be in the hands of an intellectual aristocracy. . . . Keynes tended till the end to think of the really important decisions being reached by a small group of intelligent people, like the group that fashioned the Bretton Woods plan." Arthur Smithies (1951, pp. 493–94) also discussed the authoritarian-central planning mindset of Keynes when he wrote that "Keynes hoped for a world where monetary and fiscal policy, carried out by *wise men* in authority, could ensure conditions of prosperity, equity, freedom, and possibly peace."

Solow himself championed this view of the economist as central planner in a very influential article co-authored with Paul Samuelson in the *American Economic Review* (1960) which laid out the Phillips Curve framework of having an enlightened elite choose for the country the "appropriate" mix of inflation and unemployment. Macroeconomic stabilization policy, guided by Keynesian dogma, catapulted interventionist-minded economists into positions of power and prominence as apologists for state power. These economists, and the academic institutions that employed them, have also benefited financially from this relationship through generous government funding of their academic research. As Rothbard wrote in *The Ethics of Liberty* (1998, p. 172), the state subsists by "engineering the support of a majority . . . through securing an alliance with a group of opinion-moulding intellectuals whom it rewards with a share in its power and pelf."

Yet another reason for the popularity of Keynesian ideas and methods that Solow completely ignores is the rational self interest of politicians. Politicians have always viewed Keynesianism as providing intellectual cover for what they always want to do anyway: spend as much of the taxpayers' money as possible on programs that benefit special-interest groups (in return for the groups' political support) while dispersing and disguising the costs with debt finance.

Solow is such a thoroughgoing interventionist that he seems incapable of acknowledging that government intervention is ever a cause of economic instability. In his introductory chapter he ponders the question of why price reduction does not always seem to occur during recessions or depressions and presents five possible reasons, based on pure speculation about the possible motives of business firms (the words "might," "could," and "perhaps" proliferate in his prose). One obvious reason for price inflexibility that is nowhere mentioned in Solow's book is minimum wage and other labor laws that have been designed specifically to artificially prop up compensation levels, especially in unionized industries. In this regard, Professor Solow would do well to read *Out of Work* (1993) by Richard Vedder and Lowell Gallaway, but I am not optimistic. Solow's writing is extraordinarily narrow in that his references include almost exclusively his M.I.T. colleagues and former students who all share the same overly mathematical methodology.

As with so much of mainstream economic "model building"—especially in macroeconomics—the sometimes bizarre assumptions Solow makes virtually

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guarantee that the models will give him the mathematical "results" that he desires. For example, on page 44 he assumes that "nothing changes from one year to the next." On page 34 he assumes away the price system: "There is no force that automatically works to eliminate excess supply of or excess demand for labor." "Investment goods are produced by labor alone" and they "disappear completely after one period of use" (p. 34). As he candidly admits at the end of the introductory chapter, "the particular results depend on those assumptions" (p. 5).

The essence of Solow's three essays is to replace the fundamentally flawed equilibrium model of perfect competition (flawed from an Austrian perspective, that is) with an equally flawed equilibrium model of "monopolistic competition" in his macroeconomic model building. He is deeply distressed over the fact that "economists have been scared away from Keynesian-sounding conclusions over the past fifteen years or so" (p. 25) and believes that incorporating long-ago discredited theories of monopolistic competition will somehow salvage Keynesian economics.

Solow's rigid refusal to consider government intervention as the source of economic instability leads him to pose a number of questions which he believes are profound puzzles but which in reality are quite elementary, if not simplistic. "When a modern industrial economy is struck by a real disturbance, like a sudden reduction in the perceived profitability of investment or a sudden increase in the propensity to save," he asks, "why does it take so long to return to full-employment equilibrium?" (p. 15).

Of course, a "reduction in the perceived profitability of investment" is what is caused by monetary expansion and the malinvestment that it breeds, but Solow mentions nothing of this. Such "disturbances" are simply assumed to occur, like magic, without explanation. Moreover, an "increase in the propensity to save" is nothing to be alarmed about and usually just reflects individual choices guided by rates of time preference. But Solow, like all other Keynesian central planners, believes that he knows the "correct" rate of time preference for all citizens as well as the "correct" or "optimal" savings rate and that the state should use its coercive powers to force us into this state of economic bliss.

There is a mountain of history that would help Solow understand why it sometimes takes an economy so long to "return to full employment." I would start with Murray Rothbard's *America's Great Depression* (1963), which explains how, in economic crises prior to the Great Depression of the 1930s that were *not* responded to with massive government intervention, recovery was quite rapid. Government intervention—especially in labor markets—is the reason why recessions and depressions last longer than they otherwise would. Solow ignores history and pretends that such events are a Great Mystery that can only be unraveled by a garble of exquisite mathematical trivia. In a sense, mathematical economics is but a branch of hermeneutics—the "truth" is whatever these mathematical hermeneuticists say it is regardless of facts, history, and even logic.

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At one point Solow seems ready to temporarily suspend his reliance on unrealistic mathematical models that admittedly explain very little about the economy and embark upon a path that will actually improve our economic understanding. Such a passage occurs on page 19, where he makes the Kirznerian statement that "it is very important to know something about the forces that lead the economy to 'choose' one equilibrium configuration rather than another." But one is quickly disappointed. He says nothing about entrepreneurship—or about human action for that matter. Instead, he talks about mysterious "historical, accidental, sociological, and even psychological factors" without offering any hint as to just what these "factors" might be. Not a reference, not a footnote. Again, there is no mention at all of how government itself affects the market system other than as a benevolent tool of "stabilization policy": "One function of economic policy may be to help or induce the economy to choose a better rather than a worse equilibrium." This really is a naive child's view of government.

Solow at times descends into what Mises might have called the "cloud cuckoo land" when he presents theories of how "animal spirits" supposedly guide investment behavior ("What we have . . . constructed is a theory in which animal spirits . . . drive investment," he says on page 25). He also makes a mountain out of a mole hill in referring to a "literature" that describes markets as "thick" (there are lots of trading partners) or "thin" (there are fewer trading partners). In Solow's theoretical world, if one wants to sell one's used car and is not immediately deluged with hundreds of offers, then there is a "thin-market externality" that needs to be "corrected" by state intervention. No such "imperfections" are *ever* hinted at with regard to the behavior of politicians and bureaucrats.

Solow considers his major "contribution" in this selection of essays to be his introduction of monopolistic competition, rather than perfect competition, into a macroeconomic model. In keeping with what appears to be an M.I.T. tradition of never reading anything but pure mathematical models and studiously ignoring history, philosophy, most alternative economic theories or schools of thought, and real-world economic events, Solow proceeds as though there have never been any criticisms of monopolistic competition theory.

But, of course, there have been so many criticisms that the theory has become an historical artifact (Kirzner 1973; Rothbard 1993). Monopolistic competition is a static equilibrium model that claims to distinguish itself from the equally absurd, static equilibrium model of perfect competition. But in perfect competition there is no genuine competition, as price cutting, advertising, product differentiation, and other genuinely competitive actions are simply assumed away. It is therefore not a valid "benchmark," regardless of how often economists may assume that it is.

Even Edward Chamberlin, the "father" of monopolistic competition theory, admitted that his theory was useless if one assumes that product differentiation—the key assumption of the theory—occurs in response to a desire on the part of businesses to cater to diverse consumer demands. Competition is a dynamic,

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rivalrous, discovery procedure that helps facilitate plan coordination among market participants, and advertising and product differentiation are essential elements of that process. The "excess capacity" story that is told by monopolistic competition theorists is contrived nonsense, but is nevertheless the keystone of Solow's model.

Just how absurd it is to label product differentiation as "monopolistic" is amplified by the development in recent years of what the management literature refers to as "mass customization" (Pine 1993). Thanks to computer technology, manufacturers have been able to create an ever-increasing variety of goods and services tailored to the individual preferences of consumers. Just since the early 1970s the number of new car models has expanded from 140 to 260; soft drinks from 20 to 87; and television channels from 5 to 185. There are now 340 kinds of breakfast cereals, 3,000 different beers, and even 50 brands of bottled water.

All of this (and much more) has resulted from the combination of a fiercely competitive global marketplace and the application of information technology to manufacturing. Economists like Solow who still insist that product differentiation is a sign of "monopolistic" behavior are mired in an interventionist mindset that is not even remotely in touch with reality.

Murray Rothbard wrote in *Man, Economy, and State* (1993, p. 643) that "we must never let reality be falsified in order to fit the niceties of mathematics" but, of course, that is exactly what Solow and most other mathematical economists do. It is the coin of their theoretical realm. In Solow's case, he ignores or falsifies reality so that his contrived model can help him arrive at the conclusion that central bank monetary expansion will have nothing but benign effects. "If the money supply is increased," he writes, "the output of consumption goods increases more than proportionally, . . . output per worker increases, and so does the real wage" (p. 49). Can the cure for the common cold be far behind?

Equally contrived is the model discussed in chapter 3 which concludes, in complete contradiction to sound economic logic, that "wage cutting in the presence of unemployment would be a step in the wrong direction" if one wishes to increase employment (p. 59). No evidence is offered in support of this conclusion, only the gobbledygook of mathematical economics. The model is said to be "a version of the Hotelling–Lancaster–Salop model of monopolistic competition with a circular product space, and the equilibrium concept is symmetric Chamberlinian" (p. 60). (Attention graduate students: Talk like this in job interviews and you could land a faculty spot at M.I.T.!).

Solow seems to have no conception of human action as a process of plan coordination, although he uses Austrian-sounding language at one point in discussing "coordination failure" in the marketplace. He sees the job of the economist as the construction of obtuse mathematical theories to ostensibly explain this alleged "failure," but not to inquire how market participants act to overcome coordination problems. He doesn't appear to be the least bit interested in how

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markets actually work; only to "model" them as inherently "flawed" in order to stroke his own ideological predelictions.

It speaks ill of the economics profession that one of its gray eminences, Robert Solow, who has been "building models" for some fifty years, offers a macroeconomic model that fails to incorporate a discussion of asset and labor markets. Deep down, I suspect that he must recognize the absurdity of it all. On page 35 he confesses: "I can talk about unemployment in this model, but I have not earned the right to talk about it seriously."

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TO SERVE AND PROTECT: PRIVATIZATION AND COMMUNITY IN CRIMINAL JUSTICE. BY BRUCE L. BENSON. INDEPENDENT INSTITUTE AND NEW YORK UNIVERSITY PRESS. 1998.

To Serve and Protect is a breath of fresh air in the fog of mainstream recommendations concerning security, crime, and punishment. In the mainstream literature, liberals typically regard the offender as the victim of an egoistic society and conservatives typically say that the only way to reduce crime is to increase the severity of punishment (Ehrlich 1972, 1973, 1977, 1981, 1996; Stigler 1970; Becker 1968). Benson brilliantly shows that the solution to the problem of criminal justice does not rest with increasing law-enforcement budgets (pp. 2–3) or imposing harsher punishments, but with privatization.

The crisis in the administration of justice is part of a more general crisis: that of the welfare state. Government monopolization of security and justice exhibits the failures symptomatic of other government programs (poor service and inefficient rationing). The feeble results of the struggle against crime and for justice derive from a system-wide failure, where the interdependent links between public institutions make partial governmental solutions impossible. The police and judiciary systems are part of a politicized mechanism, and, consequently, are unable to evade inner contradictions inherent in all government provision of services (chaps. 11–12).

Benson argues that private crime control is possible and that thorough privatization would be more attentive to the demands of justice (chap. 5). For this reason, the market for specialized security services and equipment has been flourishing. Even under the constraints of the present system, private spending for protection of person and property is double that of public spending. In 1991, the ratio between private and public employment in security services was approximately 2 to 5. Between 1964 and 1991, the number of firms increased 543 percent, and it increased 745 percent in terms of employees. In some cities, voluntary group actions prevent crimes where the public police long ago decided not to go (p. 88). The same privatization path is being taken in the administration of justice. Today, private firms handle every manner of dispute: business, personal injury, divorces, construction warranty disputes, loan defaults, and many other areas. Benson argues that this experience both highlights the failure of government and illustrates the effectiveness of private enterprise (p. 116).

However, privatization of justice must cover the entire production of justice, as Benson shows by discussing the shortcomings of partial privatization. The first

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case of partial privatization refers to "contracting out" methods. In 1994, for example, 49,154 prisoners in more than 60 private prisons were controlled by roughly 21 private firms (p. 22). Better management by the private sector has permitted a cut in costs of 10 to 50 percent. Competition among firms has created the incentives to increase productivity and to discover new techniques of production (p. 33). In spite of being an important improvement, the "contracting out" option cannot first be assimilated to a true private justice. It can be only a first step towards a completely open market. Otherwise it is likely to produce certain perverse effects, which are often wrongly attributed to the private sector, such as bribing and corruption. Bureaucrats can take advantage of their position and negotiate special privileges, and they can destroy the mechanisms of competition by erecting legal barriers (p. 43-46).

Another instance of the failure of partial privatization is that it does not address the rights of the victims. In most cases, the judicial process simply ignores crimes that are not considered serious. The careers of judges and prosecutors become more important than restitution for victims (p. 62-64). The *plea-bargain* is an example of these symptomatic disorders of the justice system. The victim is missing from the process altogether, so that the pseudo-efficiency of the system can be enhanced. This type of bargaining is in fact the result of the inability of government to properly produce justice:

> A plea or charge bargain is an exchange agreed upon by negotiating *parties*, and it might be expected to improve the *efficiency* of the criminal justice system. . . . Indeed, the typical justification for the widespread use of plea bargaining is that it relieves some of the pressure on the prosecutorial and judicial systems arising from court crowding and delay. (p. 62; emphasis added)[1]

We could share Benson's analysis and follow him in his conclusions; however the theoretical framework is insufficient, and the book fails to clearly establish the limits of law.

For example, Benson identifies a form of informal justice—that which circumvents the public sector but which is not subject to market discipline. This is also known as "taking the law into you own hands," and can often involve the destruction of assets and physical punishment. Is it correct to identify this sort of behavior as self-justice, as Benson does, or does it simply constitute revenge? To note the reaction of a distraught population towards criminality and injustice is one thing, but to identify these behaviors to a type of private justice is another (p. 120).

Moreover, can we really talk about privatization, when the given examples deal only with particular forms of substitution of public justice or private ones, and when the core of justice remains public and the monopoly of the government? The private sector can only make so many strides when government retains a monopoly in deciding what the law is and how it is to be enforced. At most, Benson's

[1] Does justice imply the presence of a third person: arbitrator, judge, and mediator to ensure fairness in the process and proportionality in the sentence (Rothbard 1998)?

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examples of privatization illustrate the social advantages of private markets for security and justice, but they do not illustrate the workings of true privatization.

A more narrow class of problems is connected with Benson's neoclassical economic outlook. In this view, criminality and punishment are analogized to market exchange, where there is a demand for crime, a supply of criminal possibilities, and punishments are treated as prices for services (p. 51). There are grave problems associated with this approach. For example, a government system ends up determining the expected price for crime. But can we really call an arbitrary value determined unilaterally by a governmental institution a price? A price has a real meaning only in a free market. More fundamentally, it is not possible to speak of a demand for crime, any more than it is possible to find suppliers who offer, at a price, three rapes, two thefts, and three murders. Unlike crime that is an aggressive procedure for appropriation, the market is based upon voluntary agreements. Consequently, crime and exchange are two different, incompatible, irreconcilable phenomena, which is why a "market for crimes" cannot exist (Erhlich, 1996). Benson commits the same error by asserting that Mafia organizations are one example of a form that the private sector could take (p. 112). Private institutions respect property rights and apply the rule of law, whereas the state does not. In that sense, a Mafia that uses violence and extortion is better seen as a primitive state in competition with other primitive states.

Another problematic area is the way Benson explains the expected benefits of privatization (chap. 7). He argues his case primarily by providing examples of the improvements in resource allocation that can be expected. The lack of knowledge and the disincentive for research obviously skews the judgment of those who produce security and justice. In a similar way, the arbitrariness of the political system (pp. 128–34) can bring about a situation in which offenders do not serve their sentences[2] and where there is too much focus on enforcement of some types of crimes (say, for example, ingesting illegal drugs) even as such enforcement causes the rate of other crime rates to rise (say, for example, crimes against property to pay the artificially high prices of these drugs; p. 139).

But reducing the benefits of the privatization of justice to a cost–benefits analysis has its limits. It does not address more fundamental issues concerning what should and should not be considered a crime in a free society. Are drug dealers always to be considered as criminals in a libertarian society? Will prostitutes still be considered outlaws even though they supply voluntary services (Block 1976)? There are many other such "victimless crimes" or crimes against the state which the libertarian society may permit or which would not exist, among which we might include insider trading, money laundering, and tax evasion. About these issues, Benson says nothing. And yet this is a crucial concern. Is the role of justice

[2]The inability of government to manage the judiciary system explains also why the punishments are extremely low. Indeed, the average expected punishment for a murder is 2.99 years, 338 days for a sexual offense, 4.5 days for theft, and 10 days for an automobile theft (p. 68).

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to intervene in private relationships when no harm (no violation of property rights) is done? The idea that the privatization of justice amounts to little more than the application by private firms of the law produced by governmental institutions is a restrictive view of the problem. It begs the crucial question of what type of law must be enforced, an issue that would be addressed in a private system in a radically different manner.

Moreover an argument about justice cast solely in terms of benefits and costs suggests that efficiency is the only issue; a theory of justice must also deal with the legitimacy of law enforcement. Many issues of criminal law today deal with a conflict between the efficiency of law enforcing institutions and private-property rights. For instance, he writes, *"if someone is carelessly hired or trained to be a police officer uses excessive force and violates a person's rights, a local government is not likely to be liable for damages"* (p. 180). In other words, governmental agents can still violate the rights of citizens to enforce the law. This opens a Pandora's box.

Benson also seeks to support the case for the privatization of criminal justice by an analysis of the history of law and enforcement in private-property societies (pp. 94–13, 198–212). In the first Anglo-Saxon societies, for example, justice was dispensed according to custom on an entirely private basis, and in this system, only crimes against person and property called forth restitution. Only as the government became centralized did the definition of crimes begin to broaden, while fines and property confiscation became a source of revenue instead of a means of restitution (p. 205).

As important as history and examples are, however, they do not substitute for a strong theoretical perspective. One can well imagine a treatment from the opposite perspective, written by a scholar as brilliant as Benson, who could provide other examples, other interpretations, and additional factual analysis justifying more government intervention in the criminal justice system. This same author could explain that the failures of the judicial system are the consequence of capitalism. As it stands, Benson's argument is vulnerable to being overturned by this approach, whereas a more developed theoretical framework (Rothbard, 1998) would have given his overall argument more analytical power.

Nonetheless, and despite its analytical flaws, Benson's book is a worthy contribution to identifying both the source of the problem, the state and its victim-creating policies, and the means of its solution, the privatization of police and justice.

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THE POLITICAL ECONOMY OF THE NEW DEAL. BY JIM F. COUCH AND WILLIAM F. SHUGHART II. CHELTENHAM, U.K.: EDWARD ELGAR, 1998.

With another U.S. presidential election nearly upon us, it is almost certain that Democratic party candidates (and some Republicans) will evoke the name of Franklin Delano Roosevelt, the president whose administration gave America the New Deal, which historians and all-too-many economists believe was an appropriate response to the Great Depression. Since *Time* Magazine named FDR as one of the greatest men of the century, we shall once again hear how Roosevelt and his "New Deal" lifted the country from the depths of the depression and once again gave us hope—and the kind of government that could respond to whatever crisis would ail our body politic.

The New Deal did no such thing, of course, but politicians and academic scribblers are fond of telling their audiences that Roosevelt's creation of a gaggle of alphabet-soup programs was an "innovative" and "compassionate" response to the economic calamity caused by the "collapse of capitalism." If winners truly write history, then the dearth of books by economists critical of the New Deal—despite the fact that the Great Depression has been studied more than any other economic event in U.S. history—clearly demonstrates where free markets rate with much of this country's intelligentsia.

Economic literature that challenges the New Deal orthodoxy is fairly scant. Murray Rothbard's *America's Great Depression* (1963) successfully refutes the charge that the economic collapse was a failure of the free market. However, Rothbard stops his historical analysis at the end of Herbert Hoover's term and does not deal directly with Roosevelt's programs.

The Political Economy of the New Deal by Jim F. Couch and William F. Shughart II is an addition to the literature which dissents from the intellectual *zeitgeist*. The outgrowth of Couch's doctoral dissertation at the University of Mississippi, the book takes a public-choice approach as it examines the policies of the Roosevelt Administration. The authors demonstrate how raw politics drove the New Deal programs, as opposed to the common conception that such programs were simply a response to the "genuine need" facing millions of unemployed or underemployed Americans. In fact, as the authors point out on numerous occasions, the states with the least economic distress often received the lion's share of New Deal money, as opposed to those areas of the country hit hardest by unemployment and poverty.

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Couch and Shughart's book brings together a number of public-choice studies by other authors which have appeared in various journals, but have never been formally connected to each other in a single book. The authors also perform their own statistical tests, using data discovered by Leonard Arrington in 1969 that lists detailed New Deal expenses across states. Because *The Political Economy of the New Deal* depends upon interpretation of numerous statistical tests, it is not exactly the book you might want to give to your favorite history professor who insists that Roosevelt saved the country.

Before examining the strengths of this book, we first criticize its most glaring weakness from the Austrian point of view: the inability to pinpoint causes of the economic downturn. In defense of the authors, this is not a book on business cycles, nor do they claim any special knowledge of what triggers boom and bust. However, they fail to even mention Rothbard's work, although they cite Vedder and Gallaway several times.

Couch and Shughart unwittingly come close to explaining the cause of the crash (p. 12) when they refer to the disastrous attempts by Britain's Chancellor of the Exchequer Winston Churchill to return the pound to its pre-World War I standard. As Rothbard pointed out in *America's Great Depression,* Churchill convinced the Federal Reserve to follow an easy money policy, which led to the stock-market bubble which ultimately collapsed in 1929. Instead of continuing with this theme, the authors enlist the explanations of John Kenneth Galbraith to dismiss it.

They then turn to the monetarist explanation, that the Federal Reserve failed to keep the banking system afloat by lending through its discount window. They are on more solid ground here, especially when they examine the issue from a public choice point-of-view. According to Friedman and Schwartz, the Fed's failure to bail out the troubled banks resulted from myopia on behalf of the central bankers, who were engaged in a power struggle in the vacuum left behind by the death of New York Fed Governor Benjamin Strong in 1928. Anderson, Shughart, and Tollison (1988) demonstrated that the Fed's policy was rational in that it ultimately strengthened the position of member banks, not to mention greater monetary powers given by Congress to the Federal Reserve itself.

Rothbard disputes the "dastardly Fed" argument in *America's Great Depression* by pointing out that the central bank did, indeed, try to pump up bank reserves from 1930 to 1932. The problem was not that the Fed was failing in its attempts to increase the money supply, as economically unsound as the policy may have been. Rather, the Fed's efforts were thwarted by banks who increased their excess reserves and currency holdings, and the public who did not respond to the lowering of interest rates by borrowing more money.

Rothbard's explanation for why this phenomenon occurred is simple. The malinvestments brought on by the Fed's earlier policies of monetary expansion could not be propped up by new injections of credit, no matter how attractive

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interest rates may have been. In fact, Rothbard argues that the central bank, instead of trying to inflate the currency, should have been following a policy of *deflation* and the ending of the fractional-reserve banking system.

While Couch and Shughart seem to stumble over what caused the stock market crash, they do point out the damage done by interventionist policies of President Herbert Hoover, often referring to Vedder and Gallaway's *Out of Work* (1993). Vedder and Gallaway pointed out (as did Rothbard) that the Hoover administration engaged in open "jawboning" of business leaders to keep prices and wages at high levels, thus forcing up real wages in a time of declining productivity. They also note the damage done by passage of the Smoot–Hawley Tariff of 1930, which quickly accelerated the U.S. economy's downward spiral. The Higgs thesis that the anti-business pronouncements of the Roosevelt administration created great uncertainty in the private sector also receives strong mention. They write:

> There are a number of reasons why American economic policy failed. One is the First New Deal's wrong-headed strategy of responding to the colossal decline in real output by implementing programs designed to reduce production even further. Another is a series of disastrous monetary policy initiatives, beginning with a sharp contraction in the money supply at the depression's outset and ending with a doubling of required reserve ratios at a time (1936–37) when recovery seemed to be underway. Yet another is the uncertainty created by the brain trust's anti-market rhetoric, especially so during the Second New Deal, which seemed to put private property-rights in jeopardy.

As Couch and Shughart move away from causes of the depression to the Roosevelt response, the book becomes stronger in its analysis. Their theme is two-fold. First, they accurately note that those who shaped the New Deal were strongly anticapitalist in their outlook. For example, they write that Rexford Guy Tugwell, called the "architect" of the First New Deal, was an institutionalist economist from Columbia University who believed that the price system was both inefficient and a major cause of "speculation" by greedy people. In other words, the ideology of the New Dealers did matter.

Second, they point out how politics determined the actual distribution of New Deal funds. One example they give is the dispersal of Works Progress Administration (WPA) projects. Given the supposed "compassionate" nature of the Roosevelt administration, one would think that those in the most dire need would receive the most help. Under the leadership of Roosevelt deputy Harry Hopkins, however, the WPA discriminated among states according to the political needs of the Democratic party, as government dollars were distributed according to their marginal political benefit.

Compensation was tied to area incomes. For example, an "intermediate" WPA worker in Tennessee would earn 23 cents per hour, while his counterpart in New York received $1.57. Skilled laborers working on WPA projects made 31 cents an hour in Tennessee and Alabama and $2.25 in New York. Professional pay was 34 cents per hour in Alabama and $3.03 in Pennsylvania.

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Hopkins, who uttered the infamous phrase, "We're going to tax and tax, and spend and spend, and elect and elect," justified the wide differentials in pay on regional differences in cost of living. Couch and Shughart, on the other hand, write that Hopkins was seeking maximum political returns and that marginal dollars spent in the wealthier northeastern and western states were far more effective in electing New Deal Democrats than in the South, where voting patterns had been solidly Democratic since the Civil War.[1]

Both the first and second New Deal programs were attempts to throttle movements of free markets, as the authors point out. The centerpiece of the First New Deal, the National Industrial Recovery Act (NIRA), was an unsuccessful attempt to organize nearly the entire U.S. economy into a series of cartels with codes governing output, wages, and prices. Even before the U.S. Supreme Court in 1935 declared it unconstitutional along with the infamous Agricultural Adjustment Act, the NIRA was tottering under the weight of its own contradictions.

Unlike much of the doomed legislation passed during the FDR administration's first "100 days," the Second New Deal contains legislative dinosaurs which still wreak havoc with the economy. Laws like the Social Security Act and the National Labor Relations Act, which firmly set the powers of government behind labor unions, still take center stage at every election.

One should not be able to read this book and come away with a belief that Roosevelt saved the country, or even saved capitalism. Couch and Shughart demonstrate too many times that the New Deal inhibited economic growth and thus needlessly continued the misery first wrought by the policies of Herbert Hoover.

One hopes that someone in the future will write a definitive Austrian view of the Great Depression, from its beginnings to its post-World War II end. Rothbard began the process; Couch and Shughart, while not Austrians, continue the analysis in a way that should be pleasing to most Austrians and fellow-travelers. We now await someone to take the next step and tie everything together.

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[1]The authors, unfortunately, fail to mention one of Hopkins's political master strokes: placing hundreds of writers and photographers on the WPA payroll. Many of these writers, including Studs Terkel, later rose to places of prominence and continue to write pro-FDR propaganda to this day.

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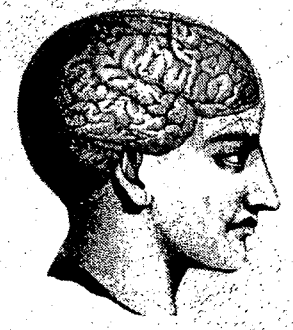

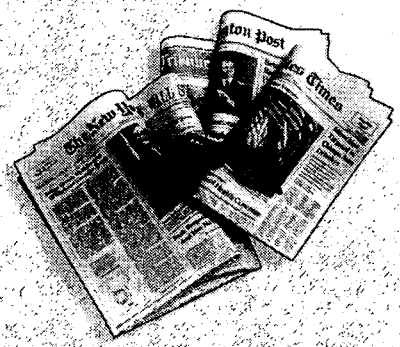

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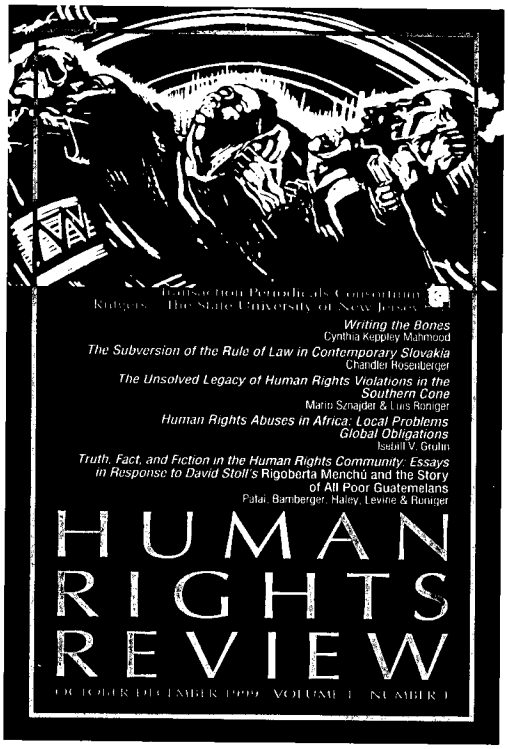
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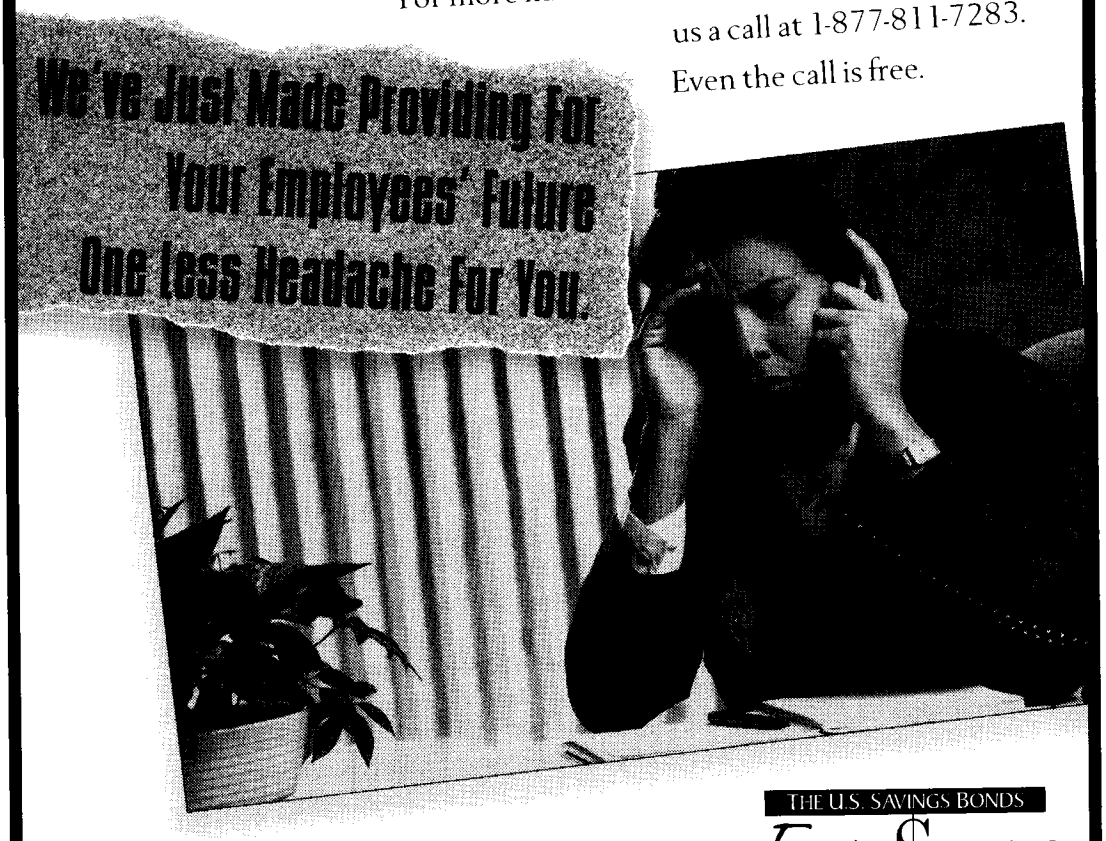

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